Supreme Court, U. S.
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80-515

No.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

W. C. YORK,

*Petitioner,*

v.

FEDERAL HOME LOAN BANK BOARD and FEDERAL SAVINGS AND LOAN INSURANCE CORP.,

*Respondents,*

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF RALEIGH,

*Intervenor-Respondent.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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## Questions Presented

1. Whether the depositors in a Federal mutual savings and loan association are owners of that association with property rights protected by the Constitution?

2. Whether the conversion of First Federal Savings and Loan Association of Raleigh, Raleigh, North Carolina from mutual to capital stock form deprived the plaintiff and its depositors of their property rights without just compensation, and its approval by the Federal Home Loan Bank Board ("Bank Board") and Federal Savings and Loan Insurance Corporation ("FSLIC") by regulations (12 C.F.R. §563b.1 *et seq.*) under the purported authority of the Home Owners' Loan Act of 1933 (HOLA) (12 U.S.C. §1464(j)) was arbitrary, capricious, an abuse of discretion and otherwise not in accordance with law and should be set aside?

3. Whether the United States Court of Appeals for the Fourth Circuit erred in affirming the Federal Home Loan Bank Board's approval of the conversion of First Federal Savings and Loan Association from mutual to capital stock form?

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FEDERAL HOME LOAN BANK BOARD and FEDERAL SAVINGS AND LOAN INSURANCE CORP.,

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FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF RALEIGH,

*Intervenor-Respondent.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The petitioner W. C. York respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit affirming the Federal Home Loan Bank Board's approval of the conversion of First Federal Savings and Loan Association of Raleigh, Raleigh, North Carolina, from mutual to capital stock form, entered in this proceeding on July 1, 1980.

### Opinion Below

The opinion of the Court of Appeals, not yet reported, appears in the Appendix hereto.

## Jurisdiction

The judgment of the Court of Appeals for the Fourth Circuit was entered on July 1, 1980, and this petition for certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

## Statutory Provisions and Regulations Involved

The pertinent sections of the Home Owners' Loan Act of 1933, as amended, 12 U.S.C. §1464 *et seq.* (Section 1725(j)), and the Federal Home Loan Bank Board's Regulations (12 C.F.R. Sections 544, 545 and 563b.1 *et seq.*)

## Statement of the Case

This proceeding arises from a petition for review of an action by the Federal Home Loan Bank Board, acting as the operating head of the Federal Savings and Loan Insurance Corporation, which purported to approve the proposed conversion of First Federal Savings and Loan Association of Raleigh ("First Federal") from the mutual form of ownership to the stock form of ownership while retaining its federal charter.

First Federal's application for permission to carry out the proposed conversion was originally filed on October 17, 1978; and on May 17, 1979, the Bank Board rejected written objections by the petitioner and other members of First Federal and purported to approve the proposed conversion by its resolution number 79-298.

On June 19, 1979, the petitioner instituted a civil action in the United States District Court for the Eastern District of North Carolina (W. C. York v. First Federal Savings & Loan Association of Raleigh, et al., No. 79-354-CIV-5). The petitioner sought a judgment declaring that the proposed conver-

sion was unlawful and ultra vires and enjoining the defendants[1] from proceeding with the conversion on the grounds, among others, that the statutory authority for such conversions expired on June 30, 1976; that the purported approval of the proposed conversion by the Bank Board was arbitrary, capricious, an abuse of discretion and otherwise not in accordance with the law, and that the proposed plan of conversion was adopted by First Federal's Board of Directors in violation of their fiduciary obligations because the proposed conversion would unfairly deprive many members of First Federal of their property and voting rights therein without just compensation while resulting in a windfall to certain other members including the directors.

On June 27, 1979, the petitioner instituted a proceeding in the United States Court of Appeals for the Fourth Circuit, pursuant to provisions of 12 U.S.C. §1725(j), expressly stating that he believed the District Court and the civil action referred to above were the proper forum for the adjudication of his challenge to the Bank Board's resolution since §1725(j) had apparently expired and that the petition for review was filed solely to preserve his right to review of that order should it be determined that, contrary to his belief, jurisdiction was properly in the Circuit Court. On August 27, 1979, the Court of Appeals granted First Federal's motion to intervene in this action. On July 1, 1980, the Court of Appeals issued its decision that petitioner's claims were without merit, and the Bank Board's position was affirmed.

## REASONS FOR GRANTING THE WRIT

### I. The legitimacy of mutual-type institutions, which the Fourth Circuit's decision challenges, is a matter of great public interest with far reaching economic and social consequences

Mutually organized institutions are a major factor in the

[1] The defendants in that action were First Federal, its directors, the Bank Board and its members and the FSLIC.

United States economy, and directly and indirectly touch the daily life of almost every citizen. Such institutions include mutual savings and loan associations, mutual savings banks, mutual life insurance companies, credit unions and cooperatives (primarily farmer cooperatives). Collectively, mutual-type institutions control or manage over *$1 trillion* in assets.

*($ Figures in Billions, as of December 31, 1979)*

| | *Assets* |
|---|---|
| Mutual Savings and Loan Associations | $438 |
| Mutual Savings Banks | $163 |
| Mutual Life Insurance Companies | $345 (est.) |
| Credit Unions | $ 66 |
| Cooperatives | $ 20 (est.) |
| | $1,032 billion |

(Sources: Savings and Loan Fact Book '80, United States League of Savings Associations; Life Insurance Factbook 1979, American Council of Life Insurance.)

As is shown in the following discussion, mutual-type institutions have been traditionally held to be owned by their depositors or customers. By definition, they have no other owners.

A result upholding the decision of the Fourth Circuit in this case could have the effect of throwing the status of the ownership of most or all mutual-type institutions into doubt. Such a result would be highly disruptive to a significant segment of the economy, which has traditionally been recognized by Congress to have a special and favored place, reflected by tax and other benefits relative to stockholder-owned, profit-making corporations.

Even if such a result supporting the Fourth Circuit could be restricted to the savings and loan industry, the results would be sweeping. There are approximately 2,322 mutual savings and loan associations with assets totalling some $430 billion dollars.

Throughout the country, Americans hold approximately 67 million accounts in such mutual associations. Collectively, these mutual savings and loan associations have a net worth of some $24 billion. If the Fourth Circuit's decision stands, the road will be open to an unrestricted transfer of ownership of that $24 billion in net worth, and control of that $430 billion in assets, from tens of millions of depositor-members of mutual associations to a small number of stockholder-investors, without just compensation.

> (Combined Financial Statements—1979, Federal Home Loan Bank Board at 7-8; Savings and Loan Fact Book '80, United States Savings and Loan League, at 63.)

It is argued in the following discussion that the depositor-members of mutual savings and loan associations do have property rights in their association (i.e., are owners of its net worth); that they have not been able to fully realize this ownership interest since the imposition of interest rate controls in 1966; that a change of terminology of accounts in 1968 from "share" to "deposit" accounts did not diminish their ownership interest; that now that interest rate controls are being lifted by Congress they can once again realize this interest; that the conversion of a Federal mutual savings and loan association from mutual to capital stock form takes this interest without just compensation; that approval of such a conversion by the Federal Home Loan Bank Board is in violation of the Fifth Amendment of the Constitution and the depositors contract rights; and that the Fourth Circuit's affirmation of the Bank Board's approval should be reversed.

## II. The action of the Federal Home Loan Bank Board, affirmed by the Fourth Circuit, has denied property and other ownership rights of the depositors of a federal mutual savings and loan association clearly recognized by other Courts of Appeals.

First Federal is an operating mutual savings and loan association which was originally chartered by the federal government

in 1937. The respondent Federal Home Loan Bank Board is an independent agency in the executive branch of the United States government (12 U.S.C. §1437(b)) and is responsible, among other things, for the chartering, organization, supervision and regulation of federal savings and loan associations, including First Federal. Section 5(a) of the Home Owners' Loan Act of 1933, as amended, 12 U.S.C. §1464(a) authorizes the Bank Board to issue charters to Federal savings and loan associations.

> "(G)iving primary consideration to the best practices of local *mutual* thrift and home-financing institutions in the United States." (emphasis added)

The Federal Savings and Loan Insurance Corporation is a corporate instrumentality of the United States government which is under the direction and control of the Bank Board. 12 U.S.C. §§1437(b), 1725(a) and (c) and 1730(b)(1). It insures the accounts of all federal associations and eligible state chartered associations; and it regulates all such insured institutions. Title IV of the National Housing Act, as amended, (NHA), 12 U.S.C. §1724 *et seq.* The Bank Board and the FSLIC are jointly referred to in this petition as the Bank Board or the respondents.

The decision of the Fourth Circuit raises questions about the very nature of a mutual savings and loan association. That question has been considered by other Circuits, with opposite results. According to the Fourth Circuit's decision:

> Although the depositors are the legal "owners" of a mutual savings and loan association, their interest is essentially that of creditors of the association and only secondarily as equity owners . . . They are not allowed to realize or share in profits of the association, but are entitled only to an established rate of interest . . . their only opportunity to realize a gain of any kind would be in the event the savings and loan association dissolved or liquidated . . . Thus, it is apparent that depositors will not be deprived of property rights by conversion to a federal stock association.

> Depositors only real rights, their rights as creditors of the association, will remain unchanged by the conversion.

This description severely diminishes what have traditionally been held to be the rights of the depositors of a mutual savings and loan association. The Court of Appeals for the Sixth Circuit, in discussing the position of the depositors in a Federal savings and loan association in *West Side Federal Savings and Loan Ass'n. of Fairview Park* v. *United States,* 494 F. 2d 404 (6th Cir. 1974) at 409-11, a case involving the taxation of the merger of mutual savings and loan associations, said:

> All (depositors) have a dual relationship to the association, being in the position of creditors as holders of savings accounts and as members, possessing certain proprietary rights, including the right to vote, the right to share the association's earnings and in its assets upon liquidation. While admitting that whatever equity exists in a federal savings and loan association resides in its depositors and borrowers, the government maintains that each depositor's equity or proprietary interest is minimal compared to his rights as a creditor.
>
> . . . .
>
> The court specifically refused to adopt the argument of the government, made also in this case, that since a depositor in a savings and loan association is a creditor for some purposes he must be considered a creditor of the association for all purposes. (citations omitted)
>
> . . . .
>
> It contends, finally, that no additional value adheres to a savings account in a federal savings and loan association because of the incidental proprietary rights which go along with membership. Thus, it is said, in reality, a withdrawable savings share account is nothing more than the equivalent of a demand deposit in a bank account.
>
> . . . .
>
> (S)ince a savings account is the only proprietary interest available in a federal mutual savings and loan association

> . . . it is improper to ignore the proprietary rights included in what they received and concentrate only on their rights as creditors.
>
> . . . .
>
> We find that each owner of a proprietary interest in Parma (savings and loan association) acquired a proprietary interest in West Side (savings and loan association) which is definite and material and it represented a substantial part of the value of the stock that was given up . . .

On the subject of members rights, the Court of Appeals for the Seventh Circuit, in *Kupiec* v. *Republic Federal Savings & Loan Ass'n.*, 512 F. 2d 147, 152-4 (7th Cir. 1975), a case affirming the rights of members to inspect the association's membership list for the purpose of communicating with other members, after noting that members have the right to vote, to call special meetings, to elect directors, to a report on the association's financial condition, and to amend, alter or repeal the association's charter, said:

> As the courts in *Murphy, Ochs* and *Durnin* recognized, the rights of the associations members are analogous to those of a corporate shareholder (footnote omitted), and in order for these rights to be more than idle gestures, association members, like corporate shareholders, must have some means of communicating with one another.
>
> . . . .
>
> As indicated earlier, we agree that the rights of the federal savings and loan association members are analogous to the rights of the corporate shareholder.

Thus, it is apparent that there is a substantial difference of opinion between Circuits as to what the rights of a member of a federal mutual savings and loan association are. It is believed that the Fourth Circuit's decision is the first Court of Appeals decision holding that members have no significant rights other than those of creditors. If this decision stands, it will mark a substantial departure from previous law.

*The Fourth Circuit's reliance on Society for Savings* v. *Bowers (349 U.S. 143 (1955)) for its holding that members' rights are insignificant is misplaced.*

The only case cited by the Fourth Circuit as support for its decision disregarding members' rights was *Bowers, supra.* If this is not a good reading of *Bowers,* the rationale and the conclusion should fall.

The issue in *Bowers* was whether an Ohio state tax law which applied to mutual savings banks and mutual savings and loan associations was a tax on the association *per se* or on the ownership interests of its members. This Court held that the tax was on the association, and thus was invalid as a state tax on federal securities, some of which were held by the association. The General Assembly of Ohio then rewrote the law to explicitly tax the "ownership interests of the depositors." This revised law was then applied and upheld, *Broadview Savings and Loan Ass'n.* v. *Peck,* 133 N.E. 2d 366, 368, 165 Ohio St. 82 (1956); *Second Federal Savings and Loan Ass'n. of Cleveland* v. *Bowers,* 151 N.E. 2d 223, 225, 168 Ohio St. 65 (1958).

This Court, in dicta in *Bowers,* noted:

> "The asserted interest of the depositors is in the surplus of the bank, which is primarily a reserve against losses and secondarily, a repository of undivided earnings. So long as the bank remains solvent, depositors receive a return on this fund only as an element of the interest paid on their deposits. To maintain their intangible ownership interest, they must maintain their deposits. If a depositor withdraws from the bank, he receives only his deposits and interest. If he continues, his only chance of getting anything more would be in the unlikely event of a solvent liquidation, a possibility that hardly rises to the level of an expectancy. It stretches the imagination very far to attribute any real value to such a remote contingency, and when coupled with the fact that it represents nothing which the depositor can readily transfer, any theoretical value reduces almost to the vanishing point.

This Court's discussion, *supra,* notes both that depositors have an "intangible ownership interest," and that they may share in the association's surplus by way of interest paid on their deposits. It was precisely this "ownership interest" that was successfully taxed by the revised Ohio tax law, which taxed the association's surplus as the property of the depositors. The discussion in *Bowers* says only that a solvent liquidation of the association (or savings bank) is unlikely. That question is not here under consideration. What is under consideration is the ownership rights of the members, and their right to share in the association's surplus by way of dividends or interest, both of which *Bowers* affirms. Thus, *Bowers* cannot be correctly cited as authority to extinguish the ownership rights of the depositors in a Federal mutual savings and loan association.

*It is well settled that mutual savings and loan associations are owned by their depositors.*

In addidtion to *West Side Federal* and *Kupiec,* other recent cases indicate the ownership rights of depositors in mutual savings and loan associations. The Supreme Court of Nebraska, in *Nebraska League of Savings Associations* v. *Mathes,* 266 N.W. 2d 720, 721-4, 201 Neb. 122 (1978), which held that the State of Nebraska could not make deposits in Federal mutual savings and loan associations because the Nebraska Constitution prohibited the purchase by the State of "stock," stated:

> A deposit in a mutual savings and loan association creates interests distinctly different than the interests created by a deposit in a bank. A depositor in a bank becomes a creditor of the bank . . . A deposit in a mutual savings and loan association, on the other hand, constitutes the acquisition of an ownership interest and a right to share in the control and the profits or losses on liquidation of the mutual savings and loan association.
>
> . . . .
>
> A multitude of cases hold that the owner of an account in a mutual savings and loan association has a proprietary

> interest therein. (Citing *Tcherepnin* v. *Knight*, 389 U.S. 332, 88 S. Ct. 548, 19 L. Ed. 2d 564; *Wisconsin Bankers Ass'n.* v. *Robertson*, 190 F. Supp. 90, 111 U.S. App. D.C. 85, 294 F. 2d 714, cert. den., 368 U.S. 938, 82 S. Ct. 338, 7 L. Ed. 2d 338 and *Family Savings and Loan Ass'n.* v. *Steward*, 232 Md. 424, 194 A. 2d 118).
>
> . . . .
>
> The shareholders have the same rights as stockholders in ordinary corporations for profit . . . In other words, the members or shareholders own the association and are entitled to conduct its affairs through their officers and Board of Directors.

Other decisions to the same effect are *Matter of Vernon Savings and Loans Ass'n., Okl.*, 580 P. 2d 518, 522 (1978); *Lanigan* v. *Apollo Savings*, 353 N.E. 2d 239, 242-3, 40 Ill. App. 3d 927 (1976); *Chickasaw Federal Savings & Loan Ass'n.* v. *Oklahoma Tax Com'n., Okl.*, 528 P. 2d 1384, 1389 (1974).

***Traditionally, mutual savings and loan associations paid their depositors dividends out of earnings, rather than interest on deposits.***

In *Tcherepnin* v. *Knight*, 389 U.S. 332, 337, 88 S. Ct. 548, 19 L. Ed. 2d 564 (1967), this Court held that a withdrawable capital share in a state-chartered mutual savings and loan association was a "security" within the meaning of the Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. §78a *et seq.* In its discussion, this Court said:

> City Savings' (the association in question) capital is represented exclusively by withdrawable capital shares. Each holder of a withdrawable capital share becomes a member of the association (citation omitted) and is entitled to "the vote of one share for each one hundred dollars . . . The holders of withdrawable capital shares are not entitled to a fixed rate of return. Rather, they receive dividends declared by an association's board of directors and based on the association's profits.

*See also, Hamblett* v. *Board of Savings and Loan Associations,* 472 F. Supp. 158 (D.S.D. Miss. 1979); *Hendrickson* v. *Buchbinder,* 465 F. Supp. 1250 (D.S.D. Fla. 1979). In fact, in 1976, the FSLIC argued the opposite of its present position as presented to the Fourth Circuit in the instant case in *Lanigan* v. *Apollo Savings,* 353 N.E. 2d 239, 242-3, 40 Ill. App. 3d 927 (1976), a case dealing with the post-liquidation distribution of an insolvent mutual savings and loan association's assets. As stated in the court's decision:

> (FSLIC) points out that the fundamental difference between a savings and loan depositor and a bank depositor is that the latter receives a pre-determined interest rate on his account, while the former by contractual agreement receives a dividend dependent upon the profitability of the the savings and loan association.

The court then went on to note that although the depositors may not have fully understood their rights, "ignorance on the part of the depositors would not be grounds for altering the fundamental relationship between Apollo and its account holders."

*Payment of mutual savings and loan association earnings to depositors was temporarily restricted by federal rate-control legislation in 1966.*

Prior to the granting of temporary discretionary rate control authority to the Federal Home Loan Bank Board by Congress in 1966 (Pub. L. No. 89-597, 80 Stat. 823 (1966)), there was no direct governmental regulation of the dividends mutual S&L's could pay to their shareholders. The law extending rate controls to S&L's was "emergency" legislation, and was supposed to expire in one year (§7). Presumably, had the controls expired as originally scheduled, the situation would have reverted to the pre-1966 status quo, and savings and loan's would once again have been free to pay dividends set solely based on earnings. The "one-year" rate controls were extended numerous times until 1980.

*The terminology of accounts in mutual savings and loan associations was changed in 1968, but the substance of the relationship between the institution and the depositor was left unchanged.*

In 1968, Congress passed an extensive piece of legislation, the Housing and Urban Development Act of 1968, Pub. L. 90-448; 82 Stat. 476. Title XVII of this Act, §1716, amended Section 5(b) of the Home Owners' Loan Act of 1933 (12 U.S.C. 1464 (b)) to do a number of things, including permitting Federal mutual savings and loan associations to change the terminology of their accounts from "shares" to "savings accounts" and to accept "time deposits." It has been argued by the Bank Board that this name change reduced the depositors status from that of members to mere creditors. (*Tcherepnin, West Side Federal* and *Kupiec,* all post-1968 cases notwithstanding). This is refuted by both the House Report and House debate on that section of the Bill which accompanied its passage.

House Report No. 1585, June 25, 1968 (to accompany H.R. 17989), in its discussion of this section, noted that it "does not represent any radical innovations in our financial system" but was merely "in keeping with today's savings habits . . ." (at 2984).

When the precise question of this change was raised on the floor of the House, a supporter of the Bill responded, "All the Amendment would do is put everybody in the same position. We are not changing the legal position of the parties with mutuals or shares (Cong. Rec., July 10, 1968, at 20539). In response to the question, "What is the commensurate responsibility of the savings and loans as between share and deposit accounts?" the answer was given, ". . . in terminology and in the very thinking of the man involved . . . there is no difference" (at 20541).

This precise question was addressed by the Supreme Court of Oklahoma in 1974 in *Chickashaw Federal Savings and Loan tions,* 472 F. Supp. 158 (D.N.D. Miss. 1979); *Hendrickson* v. *Ass'n.* v. *Oklahoma Tax Commission, Okl.,* 528 P. 2d 1384, 1386 *et seq.* a case which decided that there was no significant difference between "dividends" on "share accounts" and "interest" on "savings deposits" for purposes of taxation. Both were

treated as a distribution of earnings. The court noted that holders of savings deposits and share accounts in "deposit associations" have equal voting and other membership rights and are entitled to equal priority upon dissolution or liquidation. The court held that "the only reasonable construction" was that "payments by appellee deposit associations to holders of savings deposits and share accounts constitute payments of a 'dividend or distribution of earnings . . .' " *See also, Wisconsin Bankers Ass'n.* v. *Mutual Savings and Loan Ass'n.*, 275 N.W. 2d 130, 140, 87 Wis. 2d 470 (1979).

*Interest rate controls have now been eliminated, or are being "phased-out" by act of Congress.*

In March, 1980, Congress passed the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 132. Section 202(a) of the Bill, entitled "Findings and Purpose" states:

> "It is the purpose of this title to provide for the orderly phase-out and the ultimate elimination of the limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts by depository institutions . . ."

This objective is accomplished by §207(a), under which a Deregulation Committee is created to phase-out such rate controls over, at a maximum, a period of six years. The Senate Conference accompanying the Bill (Report No. 96-640, to accompany H.R. 4986, March 21, 1980), states, "During the six year period, the committee is directed to provide for a phase out of Regulation Q (rate controls) just as soon as possible . . ."

Thus, Congress has, by statute, terminated interest rate controls, and provided a mechanism for their phase-out "as soon as possible." Such controls on maximum rates, and on the interest rate differential between commercial and thrift institutions, have not yet been phased-out, but this law, at a minimum, creates a reasonable expectation that this will be the case within, at most, six years, and quite possibly sooner.

*With the phase-out of interest rate controls, Federal mutual savings and loan associations may return to the practice of paying "dividends" or "interest" based solely on earnings, and the depositors in such associations have a right to such payments, which may exceed what would have been allowable under rate control.*

Under the Bank Board's present regulations, the only reason a Federal mutual savings and loan association may retain earnings is for the purpose of meeting losses. 12 C.F.R. §544.1 (Charter N, 10). The regulations further provide that "in lieu of or in addition to such net earnings, any of the association's surplus funds may likewise be distributed." Sections 545.1-2(b) and (c) create an identity of interests and rights between holders of "deposits" and holders of "accounts."

Presently, these regulations must operate within the limits set by rate controls. However, with the lifting of maximum rate regulations, a Federal mutual savings and loan may set interest rates to reflect both earnings, and, if the directors so decide, the distribution of surplus above that required for reserves. In many cases, such additional surplus has been retained due to rate controls. Since there is no other authorization for surplus other than for necessary loss reserves, the remaining surplus belongs to, and should be paid to, the Federal mutual savings and loan associations' depositors, as "interest" or "dividends" on their "share" or "savings" or "deposit" accounts.

*The conversion of a Federal mutual savings and loan association to capital stock form will permanently and completely eliminate the rights of the vast majority of the (previously) mutual association's members to share in this surplus and in any future earnings, to which they would have been entitled beyond a minimum guaranteed interest rate.*

Under the Bank Board's conversion regulations, all of the ownership rights of converted associations, including First Federal of Raleigh, pass to the new stockholders. 12 C.F.R. §563b.3 (c)(8), and the depositors become creditors and nothing more.

Only those members of the mutual who buy stock in their converting association retain their property and ownership interests. This typically represents less than 4% of the mutual's members. *See* Report of the Federal Home Loan Bank Board to the Congress of the United States of America on Mutual to Stock Conversions of Savings and Loan Associations, April 15, 1978 at 16, noting that in a sample of twenty completed conversions only 3.8% of the account holders purchased stock in the converting association. The remaining 96% lost all of their ownership rights.

In return for their interest in the association, the non-stock purchasing members are "compensated" with a so-called "liquidation account." 12 C.F.R. §563b.3(f), to be maintained on the books of the association in the amount of the association's net worth on conversion, to be distributed to any pre-conversion members who have maintained their accounts without withdrawal in the event of the liquidation of the association. Earnings and other benefits accruing from the funds represented by the "liquidation account" flow to the new stockholders, as does the account itself, as old depositors withdraw from, or close, their pre-conversion accounts. This "interest" in the "liquidation account" is the sole compensation to the vast majority of pre-conversion depositors who do not buy stock, in return for passing their entire ownership interest, both voting and property rights, to the new stockholders.

Immediately prior to its conversion, First Federal of Raleigh Savings and Loan Association of Raleigh had a net worth of $13,777,272 belonging to its depositors, who were represented by approximately 34,000 savings accounts. The *pro rata* ownership of this net worth would depend on the size of each account, but by way of example, distributed evenly, this would represent an average interest of $405 per account. Following conversion to stock form, this interest ceased to exist. (Proxy Statement, First Federal Savings and Loan Association of Raleigh, May 29, 1979 at 2, 62.)

*Approval by the Bank Board of the conversion of First Federal of Raleigh, in which the property rights of the mutual's de-*

*positors were taken without just compensation, was arbitrary, capricious, and abuse of discretion, and should be set aside.*

The taking of property which occurred at First Federal of Raleigh, and is continuing to occur in other such conversions, is a clear violation of the rights of depositors in Federal mutual savings and loan associations under the Fifth Amendment to the constitution.

Since it violates basic Constitutional rights, the approval by the Bank Board of the conversion from mutual to stock form of First Federal Savings & Loan Association of Raleigh is arbitrary, capricious and an abuse of discretion, and otherwise not in accordance with law, and should be set aside, and the affirmation of this Bank Board action by the Court of Appeals for the Fourth Circuit is in error, for the reasons cited above, and should be reversed.

The Fourth Circuit, suggested in a footnote in its opinion (footnote 8, at 11), that these are "policy arguments" and are "more suitably addressed to a legislative body." The question of the taking of property rights under the Fifth Amendment to the Constitution is most emphatically not a policy question for Congress, but precisely the kind of question which it is the special province of this Court to decide.

## CONCLUSION

**For these reasons, a writ of certiorari should be issued to review the opinion and judgment of the Fourth Circuit.**

Respectfully submitted,

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# APPENDIX

## Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

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No. 79-1382

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W. C. YORK,

*Petitioner,*

*versus*

FEDERAL HOME LOAN BANK BOARD and FEDERAL SAVINGS AND LOAN INSURANCE CORP.,

*Respondents,*

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF RALEIGH,

*Intervenor,*

NATIONAL SAVINGS AND LOAN LEAGUE,

*Amicus Curiae,*

NORTH CAROLINA SAVINGS AND LOAN LEAGUE,

*Amicus Curiae.*

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Upon Petition for Review of an Action of the Federal Home Loan Bank Board and Federal Savings and Loan Insurance Corporation.

Argued: May 8, 1980 Decided: July 1, 1980

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Before FIELD, Senior Circuit Judge, and HALL and PHILLIPS, Circuit Judges.

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Howard E. Manning and Michael T. Medford (Manning, Fulton and Skinner on brief) for Petitioner; Michael L. Seabolt, Harvey Simon (Harold B. Shore, Office of General Counsel, Federal Home Loan Bank Board on brief) for Respondents; Arch E. Lynch, Jr. (John J. Geraghty, Cecil W. Harrison, Jr., Poyner, Geraghty, Hartsfield & Townsend on brief) for Intervenor First Federal Savings and Loan Association of Raleigh; (Harding deC. Williams, General Counsel on brief) for Amicus Curiae National Savings and Loan League; (L. P. McLendon, Jr., Brooks, Pierce, McLendon, Humphrey and Leonard; Daniel J. Goldberg, Silver, Freedman, Housely, Taff and Goldberg on Brief) for Amicus Curiae North Carolina Savings and Loan League.

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FIELD, Senior Circuit Judge:

On October 17, 1978, the First Federal Savings & Loan Association of Raleigh (hereinafter First Federal) filed an application with the Federal Home Loan Bank Board (hereinafter FHLBB or Bank Board) seeking to convert from a mutual form of ownership to a stock form of ownership while retaining its federal charter.[1] On May 17, 1979, the FHLBB approved the proposed conversion over the objections of petitioner and several other First Federal depositors. The approved plan was presented to the member/depositors of First Federal at a special meeting on June 29, 1979, and was overwhelmingly approved. Shortly thereafter, petitioner instituted a civil action in the United States District Court for the Eastern District of North Carolina, and filed a petition in this court for review of the agency determination.[2]

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[1] A mutual savings and loan association is "owned " by its depositors and the right of control is based upon the amount deposited by a member in his account. In practice, a depositor signs a proxy form when first opening an account which allows the officers of the association to cast the depositor's votes as they see fit. Conversion to a stock corporation would transfer ownership and right of control to shareholders purchasing stock in the assocation.

[2] This Court has exclusive jurisdiction to consider challenges to FHLBB actions under 402(j)(4) of the National Housing Act, 12 U.S.C. §1725(j)(4) and 12 U.S.C. §1730a(k).

Petitioner contends that the proposed conversion was unlawful since the statutory section authorizing conversions from mutual to stock organizations, 402(j) of the National Housing Act (NHA), expired on June 30, 1976, or in the alternative, that the Bank Board's decision to allow this conversion was arbitrary and capricious. We find these objections to be without merit and, accordingly, affirm the FHLBB.

In 1933, Congress enacted the Home Owners' Loan Act[3] which authorized the creation of federally chartered mutual savings and loan associations and also allowed previously chartered state associations to convert to federal associations. At the time the Act was passed, almost all savings and loans were organized as mutual associations; therefore, Congress adopted this form of organization for the federal system of savings and loans.

Shortly thereafter, states began passing legislation allowing state chartered mutual associations to convert to state stock associations. Conversions were perceived as necessary by many associations to raise additional capital. In 1948, Congress passed legislation allowing federal mutual savings and loans to convert to *state* stock associations. Federal mutuals converting pursuant to this amendment to 5(i) of the Home Owners' Loan Act lost their federal charters. In the ensuing years, the large number of federal mutuals converting to state stock associations resulted in an adverse impact on the federal system.

To stop the erosion of the federal system, the FHLBB imposed an administrative moratorium on federal to state conversions. Then in 1973, Congress added 402(j) of the National Housing Act[4] which gave the Bank Board authority to approve

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[3] 12 U.S.C. § 1461, *et seq.*

[4] Section 402(j) of the NHA, 12 U.S.C. §1725(j), provides in pertinent part:

(j)(1) Except as otherwise provided in this subsection, until June 30, 1976, the Corporation shall not approve, under regula-

*(Footnote continued on following page)*

conversions of federal mutual to *federal* stock associations. Section 402(j)(1), however, placed a temporary moratorium on the exercise of conversion authority to give the FHLBB time to revise and promulgate regulations governing all conversions. The final conversion statute, Public Law 93-495, enacted in 1974, continued the existing moratorium on all conversions until June 30, 1976, with the exception of fifty-one test cases. Petitioner contends that §402(j)(3), which gave the FHLBB power to grant conversions, also terminated on June 30, 1976. Respondents, on the contrary, argue that it was only the temporary moratorium on conversions which expired on that date.

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*(Footnote continued from previous page)*

tions adopted pursuant to this subchapter or section 1464 of this title, by order or otherwise, a conversion from the mutual to stock form of organization involving or to involve an insured institution, except that this sentence shall not be deemed to limit now or hereafter the authority of the Corporation to approve conversions in supervisory cases. The Corporation may by rule, regulation, or otherwise and under such civil penalties (which may be cumulative to any other remedies) as it may prescribe take whatever action it deems necessary or appropriate to implement or enforce this subsection.

(2) The number of applications for conversion which the Corporation may approve pursuant to such regulations prior to such date shall be determined by the Corporation but shall not in any case be in excess of 1 per centum of the total number of all insured institutions in existence on the date of enactment, exclusive of the number of applications submitted for filing prior to May 22, 1973. * * *

(3) Notwithstanding any other provision of law, an insured institution converting in accordance with this subsection may retain its Federal charter. * * *

(4) Any aggrieved person may obtain review of a final action of the Federal Home Loan Bank Board or the Corporation which approves, with or without conditions, or disapproves a plan of conversion pursuant to this subsection only by complying with the provisions of subsection (k) of section 1730a of this title within the time limit and in the manner therein prescribed. * * *

(5) The Corporation shall, at least annually and more often as circumstances require, render reports to the Congress on the exercise of its authority under this subsection.

—I—

The principal issue requires that we construe §402(j) of the NHA, since the FHLBB's authority to approve conversions from mutual to stock organizations depends upon whether 402(j) expired in its entirety on June 30, 1976, or only the temporary limitation on conversions terminated. If the entire section lapsed on June 30, 1976, as petitioner contends, the FHLBB had no authority to approve the conversion. If, however, 402(j) remains in effect, the Bank Board is empowered to authorize savings and loans to convert while retaining their federal charters.[5]

A reading of the statute indicates that, except for the moratorium on conversions, the provisions of Section 402(j) are designed to be permanent. The statute provides that "until June 30, 1976, the [Board] shall not approve [additional conversions]," and this phraseology, by its terms, restricts only the number of conversions the FHLBB could approve during the period prior to June 30, 1976. After that date, it would appear that the Bank Board is authorized to grant conversions, subject only to the remaining provisions of Section 402(j) and the applicable regulations.

Any ambiguity in the statute is resolved by the legislative history of §402(j). The section is a combination of Public Laws 93-100 and 93-495 and the history of both statutes demonstrates that only the moratorium was meant to be temporary. Public Law 93-100 was to provide for a "temporary prohibition" on FHLBB approved conversions. S. Rep. No. 93-149; *reprinted in* [1973] U. S. Code Cong. & Admin. News 2014, 2016. This temporary prohibition was designed to give the Bank Board time to formulate new regulations for the approval of conversions. *Id.*, at 2017. The legislative history of Public Law 93-495, which

[5] Under 12 U.S.C. §1464(i) a federally chartered mutual savings and loan association can convert, with Bank Board approval, to a state stock association. This Conversion would require the association to forfeit its federal charter.

extended the moratorium an additional two years until June 30, 1976, is also instructive as to the congressional intent to temporarily limit the Bank Board's power to grant conversions, except for a series of test cases to be studied by the Board and Congress. The Senate Report on this most recent amendment indicates that only "[t]he moratorium on conversions * * * is continued for 2 years until June 30, 1976." S. Rep. No. 93-902; *reprinted in* [1974] U. S. Code Cong. & Admin. News 6119, 6121. The sole permissible inference from this statement is that Congress recognized that only the limitation on the Bank Board's authority would lapse, not the authority itself.

Furthermore, since June 30, 1976, the FHLBB has approved thirty-seven additional conversions from mutual to stock organizations. Congress has been apprised of these approvals in the FHLBB's yearly reports to the House and Senate Banking Committees.[6] We agree with the respondents that by declining to act despite the Bank Board's known policy of continuing conversions, Congress has tacitly approved the FHLBB's action. As the Supreme Court reasoned in *Ford Motor Credit Co.* v. *Milhollin*, 48 U.S.L.W. 4145, 4148 (February 20, 1980), "(L)egislative silence * * * may * * * betoken permission or, perhaps, considered abstention from regulation." While congressional inaction alone is not controlling, it is certainly persuasive.

Moreover, we are cognizant of the "considerable respect" which is to be accorded an agency's construction of the statute it is authorized to enforce. *Ford Motor Credit Co.* v. *Milhollin*, *supra*, 48 U.S.L.W. at 4148. As the Court explained in *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965):

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[6] In a report to the Senate Banking Committee issued on July 8, 1977, the Comptroller General of the United States stated that the FHLBB's power to approve conversions lapsed on June 30, 1976. Petitioner places great reliance on this opinion; however, the Comptroller General serves merely as a Congressional fact finder and his opinions have no independent legal significance. It is noteworthy that Congress received this opinion three years ago and has taken no action to implement its findings.

> When faced with a problem of statutory construction, this Court shows great deference to the interpretation given the statute by the officers or agency charged with its administration. 'To sustain the Commission's application of this statutory term, we need not find that its construction is the only reasonable one, or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings.' (Citations omitted.)

This deference to agency interpretations is especially appropriate here where Congress has stated that the FHLBB should be given broad "flexibility" in implementing and construing §402(j). S. Rep. No. 93-902; *reprinted in* [1974] U. S. Code Cong. & Admin. News 6119, 6122.

The plain language of the statute, the legislative history and the agency interpretation convinces us that the FHLBB's authority to approve conversions from mutual to stock organizations did not expire on June 30, 1976. A contrary interpretation of §402(j) would not halt conversions, but would merely compel federally chartered mutuals to convert to state stock associations. This, in our opinion, would weaken the federal system and ignore a stated legislative goal of §402(j).[7]

—II—

Petitioner secondly contends that even if the FHLBB is authorized to grant conversions, approval of First Federal's request was arbitrary and capricious. Petitioner argues that the proposed conversion would deprive First Federal depositors of their property rights in the association while providing windfalls to those purchasing conversion stock in the savings and loan. We are of

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[7] Preventing the erosion of the federal savings and loan system was a major purpose behind the passage of §407(j). S. Rep. No. 93-149; *reprinted in* [1973] U. S. Code Cong. & Admin. News 2014, 2017. By allowing federal mutuals to convert to federal stock associations the statute obviates the need to convert to state chartered associations.

the opinion, however, that approval of First Federal's conversion was well within the broad discretion of the FHLBB.[8]

Although the depositors are the legal "owners" of a mutual savings and loan association. their interest is essentially that of creditors of the association and only secondarily as equity owners. Depositors' rights are circumscribed by statute and regulation. They are not allowed to realize or share in profits of the association, but are entitled only to an established rate of interest. The depositors do not share in the risk of loss since their deposits are federally insured, and their only opportunity to realize a gain of any kind would be in the event the savings and loan association dissolved or liquidated. As to this remote possibility the Supreme Court stated:

> If a depositor withdraws from the bank, he receives only his deposits and interest. If he continues, his only chance of getting anything more would be in the unlikely event of a solvent liquidation, a possibility that hardly rises to the level of an expectancy. It stretches the imagination very far to attribute any real value to such a remote contingency, and when coupled with the fact that it represents nothing which the depositor can readily transfer, any theoretical value reduces almost to the vanishing point. (Citations omitted.)

*Society for Savings* v. *Bowers,* 349 U.S. 143, 150 (1955). In fact, federal regulations prohibit savings and loans from dissolving without Bank Board approval,[9] and no solvent association has ever secured approval for dissolution. Thus, it is apparent that depositors will not be deprived of property rights by conversion

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[8] Although we find petitioner's charge that the Bank Board abused its discretion to be without merit, we suggest, in any event, the proper forum for addressing these contentions is the Congress. Petitioner's objections are not peculiar to First Federal's conversions, but are aimed at the inherent nature of conversions of any kind. As such, these policy arguments are more suitably addressed to a legislative body.

[9] 12 C.F.R. §546.4.

to a federal stock organization. Depositors' only actual rights, their rights as creditors of the association, will remain unchanged by the conversion.[10]

Petitioner finally submits that First Federal's conversion will result in a windfall for those purchasing stock in the association. Petitioner is under the mistaken belief that by purchasing stock in the converted association, the shareholder is buying the existing net worth of the savings and loan. The shareholders, however, do not acquire a right to dispose of the association's net worth, but only purchase the right to participate in future earnings of the savings and loan. Depositors still retain absolute control over their accounts in the association. These funds are not purchased by the new stockholders and remain with the association only for so long as the depositors wish.

We conclude that the approval of First Federal's conversion was within the discretion of the Bank Board, and was neither arbitrary nor capricious. Accordingly, the determination of the Federal Home Loan Bank Board is affirmed.

*AFFIRMED.*

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[10] Under Bank Board regulations depositors in the savings and loan also have the right of first refusal to purchase stock equal to their percentage of ownership in the mutual association.

80-515

No. 80-515

Supreme Court, U. S.
FILED
NOV 17 1980
MICHAEL RODAK, JR., CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

W. C. YORK,

*Petitioner,*

v.

FEDERAL HOME LOAN BANK AND FEDERAL SAVINGS AND LOAN INSURANCE CORP.,

*Respondents,*

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF RALEIGH,

*Intervenor-Respondent.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

## BRIEF FOR INTERVENOR-RESPONDENT IN OPPOSITION

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IN THE

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W. C. YORK,

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FEDERAL HOME LOAN BANK AND FEDERAL SAVINGS AND LOAN INSURANCE CORP.,

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FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF RALEIGH,

*Intervenor-Respondent.*

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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## BRIEF FOR INTERVENOR-RESPONDENT IN OPPOSITION

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### QUESTION PRESENTED[1]

1. Whether the Petitioner, as a member/depositor of First Federal Savings and Loan Association of Raleigh, is deprived of any property right or interest protected by

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[1]The QUESTIONS PRESENTED under the Petition do not adequately raise the question of the statutory authority of the FHLBB to approve the conversion of First Federal pursuant to Sec. 402(j)(4) of the National Housing Act (12 U.S.C. 1725(j)). For purpose of this Opposing Brief, the question of statutory authority to approve the conversion is not considered as subject to review by the Supreme Court Rule 21.1(a).

the Fifth Amendment to the Constitution of the United States by reason of its conversion from a federal mutual to federal stock association pursuant to Regulations (12 C.F.R. §563b.1 *et seq.*) of the Federal Savings and Loan Insurance Corporation?

## STATUTORY PROVISIONS AND REGULATIONS INVOLVED

The Petition for Writ of Certiorari involves pertinent sections of the Home Owners' Loan Act of 1933, as amended, 12 U.S.C. §1464 *et seq.* (Section 1725(j)) and the regulations of the Federal Home Loan Bank Board and of the Federal Savings and Loan Insurance Corporation promulgated thereunder (12 C.F.R., Sections 544, 545, 552 and 563b.1 *et seq.*)

## STATEMENT OF THE CASE

Petitioner, as a member/depositor of First Federal Savings and Loan Association of Raleigh ("First Federal"), the Intervenor-Respondent, seeks a review of action taken by the Federal Home Loan Bank Board ("FHLBB"), acting as the operating head of the Federal Savings and Loan Insurance Corporation ("FSLIC"), the Respondents herein and both agencies of the United States Government charged with the responsibility of regulating federally insured savings and loan associations. Such review of action taken by the Respondents involves the approval of First Federal's conversion from a mutual to stock form of association while retaining its federal charter pursuant to the FSLIC's regulations, Section 563b.1 *et seq.*

First Federal was initially chartered by the FHLBB on September 8, 1937 as a federal mutual savings and loan association. By modification of its original charter effective

on February 5, 1952, First Federal has since operated under the form of Charter N (12 C.F.R. Section 544.1) until the adoption of Charter S (12 C.F.R. Section 552.2) through the process of First Federal's conversion from a mutual to stock form of federal association which was concluded on September 6, 1979.

The conversion of First Federal from a mutual to stock form of federal association was accomplished through First Federal's application initially filed with the FHLBB on October 17, 1978 pursuant to the conversion regulations of the FHLBB (12 C.F.R. Section 563b.1) and the included Plan of Conversion adopted by the Board of Directors of First Federal. As subsequently amended by action taken by the Board of Directors through May 10, 1979, the application for conversion and the included Plan of Conversion was approved by the FHLBB (Resolution Number 79-298) on May 17, 1979, subject to a compliance with certain conditions including, among others, the approval of the Plan of Conversion by at least a majority of the votes eligible to be cast, in person or by proxy, by the members of First Federal at a meeting at which the Plan of Conversion is submitted for their approval. (12 C.F.R. Section 563b.6) At the meeting of members held on June 29, 1979 the Plan of Conversion was approved by 1,213,156 votes in favor of conversion, or 71.6% of the votes eligible to be cast, and only 100,850 votes, or 5.9% of those eligible to be voted, were cast against the conversion. Prior to the FHLBB's approval of the conversion (Resolution No. 79-298), the FHLBB had considered and rejected the Petitioner's written objections to the conversion.[2]

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[2]Exhibits B(1) and B(2) to the Petition for Review (Complaint filed in the United States District Court for the Eastern District of North Carolina (No. 79-254-CIV-5)).

Thereafter, pursuant to 12 U.S.C. §1725(j)(4) and 12 U.S.C. §1730a(k), the Petitioner applied directly to the United States Court of Appeals for the Fourth Circuit for a review of the action of the FHLBB approving the conversion. The Petitioner's grounds for review were set forth under the form of the complaint which Petitioner had filed in a civil action instituted on June 19, 1979 in the United States District Court for the Eastern District of North Carolina (No. 79-354-CIV-5). Such civil action was brought by the Petitioner against the Respondents, First Federal and its directors challenging the legality of the conversion. First Federal's motion to intervene in the review before the Court of Appeals was allowed on October 27, 1979. By Order of the Court of Appeals entered on September 27, 1979, Petitioner's motion to stay the review in the Court of Appeals was dismissed. The civil action now pending in the District Court has been held in abeyance pending further orders of that Court.

On July 1, 1980, the Court of Appeals issued its decision which concluded that the approval of First Federal's conversion was within the discretion of the FHLBB, was neither arbitrary nor capricious, and the action of the FHLBB approving the conversion was affirmed.

## SUMMARY OF ARGUMENT

The question before the Supreme Court on certiorari is directed to a consideration of the extent of a member/depositor's interest in a federally chartered mutual savings and loan association. The cited court decisions relied on by the Petitioner describe that interest, for certain limited purposes, as one similar to that of a stockholder in the ordinary corporation. At best, the legal status of a mem-

ber/depositor in a mutual savings and loan association is *sui generis* having characteristics partaking of both a creditor and stockholder relationship. However, a consideration of the basic question which the Petitioner raises is directed to whether or not the interest of a member/depositor of a mutual savings and loan association, however labeled, is extensive enough to represent a property interest in a constitutional sense entitled to any of the protective safeguards afforded by the Fifth Amendment to the Constitution.

The Petitioner's formal objections to the conversion of First Federal from a mutual to stock form of association focus upon his assertion that the conversion deprives him of a property interest "without just compensation" contrary to the Fifth Amendment. In this, Petitioner apparently relies on that provision precluding any "taking of property for public use without just compensation." Petitioner's reliance on this provision of the Fifth Amendment is misplaced since under no circumstance has there been a *direct appropriation* by the Federal government through the instrumentalities of the FHLBB or the FSLIC of any asserted property interest of the Petitioner. If Petitioner's objection under the Fifth Amendment encompasses a claim of deprivation of property contrary to the due process clause, such an objection must also fail for lack of a protected property interest.

The decision of the Court of Appeals properly rejected the Petitioner's constitutional claim of deprivation of property without just compensation. Manifestly, there is no important question of Federal law requiring decision by the Supreme Court on certiorari and, accordingly, the Petition should be denied.

## ARGUMENT

### I. No Conflict of Opinions among the United States Courts of Appeal of the Different Circuits as to the Extent of a Depositors' Protected Rights or Interests in a Federal Mutual Savings and Loan Association under the Fifth Amendment to the Constitution of the United States.

The Petitioner asserts that the Court of Appeals for the Fourth Circuit's decision in the matter before this Court is contrary to the cited decisions (Petition, at pages 7-8) of the Courts of Appeals for the Sixth and Seventh Circuits in the Fourth Circuit's conclusion:

> Thus, it is apparent that depositors will not be deprived of property rights by conversion to a federal stock organization. Depositors' only actual rights, their rights as creditors of the association, will remain unchanged by the conversion.

While the decisions cited by the Petitioner are pertinent to an analysis of the distinguishing characteristics of a mutual depositor's (creditor/stockholder) relationship to the mutual association, on the particular matters at issue, these rulings do not pass directly upon the question of whether or not the depositor of a mutual savings and loan association has a protected property interest in voting rights or in the net worth of a federal mutual savings and loan association subject to the protective safeguards afforded under the Fifth Amendment to the Constitution. Accordingly, there is no conflict of decision between the Courts of Appeals of the Sixth and Seventh Circuits and the Fourth Circuit's decision now before this Court that

the conversion does not deprive the Petitioner of any protected property interest under the Fifth Amendment.

The Petitioner suggests that his depositor status to First Federal is like that of a stockholder and this is further amplified by the Congressional enactment of the Depository Institutions Deregulation Monetary Control Act of 1980. PUB. L. 96-221, 94 Stat. 132. By this enactment, he urges (Petition, at pages 14-15) that the planned phase-out of interest rate controls under Regulation Q over a period of six years provides a "reasonable expectation" that such will be done and thereby confers to mutual depositors a type of unrestricted interest in the remaining surplus of a savings and loan association after provision for loss reserves. In all candor, it is difficult to see how this legislative development and the prospective possibility of a phase-out of interest rate controls has any bearing on the Petitioner's deprivation of property claim. Significantly, any elimination of interest rate controls will inure to the Petitioner's benefit if he chooses to remain a depositor in First Federal. Accordingly, this prospective advantage should not be considered as an addition to the spectrum of interests which are advanced as distinguishing characteristics of the debt (creditor) or equity (stockholder) interest of a depositor in a mutual savings and loan association. As noted above, the existence or weight to be given the contrasting characteristics of a creditor/stockholder status are not determinative on the question of the Petitioner's claim of a protected property interest under the Fifth Amendment.

## II. No Important Question of Federal Law has been Raised by the Petitioner in Challenging the Legality of the Conversion of First Federal Savings and Loan Association of Raleigh from a Federal Mutual to Stock Form of Savings and Loan Association.

*A. The Indirect Economic Impact of Conversion is not Subject to Judicial Scrutiny.*

In support of the Petitioner's position before this Court, he urges that the decision of the Court of Appeals could have the effect "of throwing the status of the ownership of most or all mutual-type institutions into doubt." (Petition, at page 4.) He further asserts that if the decision of the Court of Appeals could be restricted to the savings and loan industry "the results would be sweeping." (Petition, at pages 16-17.) Essentially, through the claim of a protected property interest under the Fifth Amendment, he seeks to frustrate the will of the Congress, which has authorized the conversion of a federal mutual-type savings and loan association to stock form. As correctly noted in the opinion of the Court of Appeals, these are "policy arguments" and are "more suitable addressed to a legislative body."

The legitimacy of mutual-type institutions, and specifically the conversion of a federally chartered mutual savings and loan association to stock form, is not a proper subject of judicial concern. It is settled that economic legislation involving policy matters and, particularly, as applied to the wisdom of federal legislation (12 C.F.R. 1725(j)) authorizing the conversion of federal mutual savings and loan associations to a stock form of federally chartered

savings and loan association, are matters best left for decision by the Congress.[3]

*B. The Petitioner, as a Member/Depositor of First Federal, has not been Deprived of any Significant Property Interest by Reason of the Conversion.*

In both judicial proceedings[4] initiated by the Petitioner attacking the conversion, and before this Court, the Petitioner asserts a deprivation claim "without just compensation" contrary to the Fifth Amendment. While the Fifth Amendment forbids the taking of property for public use without just compensation, this prohibition refers only to a direct governmental appropriation of an individual's property.[5] Absent such a taking, there can be no exercise of the judicial function of awarding compensation.

Undeniably, the Petitioner has raised a deprivation of property claim under the Fifth Amendment which necessarily revolves around the federal government's regulatory control over a federally chartered savings and loan association. Assuming, arguendo, the Petitioner has properly presented a due process claim under the Fifth Amendment, it is clear that he has not been deprived of a significant prop-

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[3]East New York Sav. Bank v. Hahn, 326 U.S. 230, 66 S.Ct. 69, 90 L.Ed. 34 (1945); Home Building and Loan Association v. Blaisdell, 90 U.S. 398, 54 S.Ct. 231, 78 L.Ed. 413 (1934); Kargman v. Sullivan, 582 F. 2d 131 (1st Cir., 1978).

[4]See note 2, supra.

[5]O'Bannon v. Town Court Nursing Center, . . . U.S. . . . , 100 S.Ct. 2467, . . . L.Ed. . . . (1980); Public Service Commission of Montana v. Great Northern Utilities Co., 289 U.S. 130, 53 S.Ct. 546, 77 L.Ed. 1080 (1933); Laycock v. Kenny, 270 F. 2d 580, (9th Cir., 1959), cert. denied, 361 U.S. 933, 80 S.Ct. 373, 4 L.Ed. 2d 355 (1960).

erty interest entitled to due process protection. Alternatively, if such a property interest exists adequate procedural safeguards were provided in connection with the conversion of First Federal from a federal mutual to stock form of association.

The test of a recognizable property interest entitled to due process protection was stated in *Board of Regents of State Colleges* v. *Roth,* 408 U.S. 564, 577, 92 S.Ct. 2701, 2709, 33 L.Ed. 2d 507 (1972) as follows:

> To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it.

From the inception of the Petitioner's status as a member/depositor of First Federal, it was subordinate to the applicable Federal law, regulations, charter and by-law provisions pursuant to which First Federal was organized and operated. Here, the Petitioner, as a single depositor of First Federal, seeks to frustrate the authority of the Congress and the administrative action of the FHLBB and FSLIC approving a change of the form in which the savings and loan business of First Federal is conducted. The effect of the conversion, both *dejure* and in fact, involves a single entity-type restructuring of corporate form and nothing else. The fact of conversion does not deny to the Petitioner the right, if he elects to do so, to continue his depositor relationship in the same and uninterrupted business as First Federal was engaged prior to the conversion. This change in form simply terminates his membership status and the incidental voting privilege accorded to such status under the applicable Federal law.

The Petitioner's claim of deprivation of a property interest protected under the Fifth Amendment arises out of the very procedural limitations as existed at the very source of his claim, including the reserved right of amendment of the laws under which First Federal is formed, the regulations issued thereunder, and the charter and by-law provisions under which it operates. The Petitioner's only claim of statutory entitlement to a share in the net worth of First Federal arises only in the unlikely event of its complete liquidation. Under the reasoning of *Roth, supra,* he has only a "unilateral expectation" prior to a complete liquidation. Thus, in a constitutional sense, the Petitioner in this aspect is not deprived of any protected property interest by reason of the conversion.

While the cited dicta statement (Petition, at page 9) of the Supreme Court in *Society for Savings* v. *Bowers* (349 U.S. 143 (1955)) may have been relied on by the Court of Appeals in reaching its conclusion that the depositors "will not be deprived of property rights by conversion", such statement was properly evaluated and considered by that Court if for no other reason than to reflect the insignificant nature of the depositors' contingent ownership interest in a mutual savings and loan association.

The Federal law authorizing the conversion, the implementing conversion regulations and the adopted Plan of Conversion overwhelmingly approved by First Federal's members provide by charter amendment (Charter S) for the termination of Petitioner's membership status in First Federal with voting rights limited to the stockholders of First Federal in its converted form. The Petitioner's isolated loss of voting rights, in actuality, is *de minimis* and is not subject to absolute protection under the Fifth Amendment.

## III. The Conversion Regulations are Reasonable and Have a Rational Basis in the Implementation of a Legitimate Public Interest; Provide Adequate Safeguards for the Protection of the Interest of Mutual Depositors; and are Valid under the Fifth Amendment to the Constitution of the United States.

The Congress has provided for the conversion of Federal mutual savings and loan associations to Federal stock savings and loan associations while retaining their charters. Section 1725, specifically (and the referenced Section 1464, generally) confers on the FHLBB, directly and as the operating head of the FSLIC, the broad rule making authority to promulgate regulations in the accomplishment of this objective. Section 1725j(4) expressly provides that in the granting of conversion approvals, the FHLBB will consider certain standards in order to achieve, among others

(C) an appropriate distribution between State chartered and Federally chartered entities;

(F) the meeting of capital needs; and

(G) such other reasonable results as it may consider necessary or appropriate in the public interest.

Under the conversion regulations (12 C.F.R. Section 563b.1(3)), the FSLIC made specific findings in order to protect against the declared undesirable results of providing for a distribution to the accountholders of a converting mutual insured institution and the creation of strong incentives for significant shifts of savings funds among insured institutions thereby unacceptably threatening their financial stability (the referenced "windfall distribution"). The FSLIC then concluded that the right to share in the

"liquidation account" in the event of a subsequent liquidation of a converting association is designed

> . . . virtually to eliminate the "windfall" aspect of conversion and the resulting disruptive effect on the economy. Accordingly, the Board finds that these regulations provide a means by which mutual insured institutions may convert to stock form on an equitable basis.

The conversion regulations provide adequate safeguards for the protection of the interests of First Federal's depositors. The conversion may only be effected after publication of notice with opportunity to file written objection with the FHLBB to the conversion[6], the solicitation of the votes of eligible members in support of the conversion under proxy materials filed with the FHLBB[7] and the express condition that the conversion receive not only the required administrative approval but also the approval of First Federal's members by a majority of votes eligible to be cast[8]. In addition to these procedural requirements, the conversion regulations further provide a substitution of the depositors' inchoate interests in the surplus of the converting association for an equally inchoate interest in the post-conversion "liquidation account" established for their benefit[9]. Also, the depositors are given first priority to purchase capital stock in the converted association in accordance with prescribed formulae[10]. The conversion reg-

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[6]12 C.F.R. 563b.4.

[7]12 C.F.R. 563b.5.

[8]12 C.F.R. 563b.6.

[9]12 C.F.R. 563b.3(f).

[10]12 C.F.R. 563b.3(c).

ulations are clearly an appropriate means to a legitimate legislative end and have a reasonable and rational relationship to the purpose intended by the Congress pursuant to the authority conferred under the applicable provisions of the Home Owners' Loan Act of 1933, as amended.

In sum, the Petitioner has not suffered a taking or deprivation of any protected property interest under the Fifth Amendment as a consequence of First Federal's conversion from mutual to stock form. His fundamental proprietary interest, viz., his deposit account and the withdrawable rights thereunder, remain intact and unimpaired. The incidental right to vote which the Petitioner lost as a result of the conversion is not such an interest as would preclude either a modification or denial of such right under the Fifth Amendment.

The Petitioner's claim of a deprivation of property rights is directed to the indirect effects which have resulted from the implementation of governmental policy in respect of the regulation of a vital segment of those financial institutions created, organized and operated under Federal law. The Congressional determination to permit the conversion of federal savings and loan associations from a mutual to stock form is not destitute of basis or so arbitrary or capricious as to place the legislation and the conversion regulations of the FSLIC beyond the constitutional authority of the Congress.

## CONCLUSION

For the foregoing reasons, it is respectfully submitted that the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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*Counsel for Intervenor-Respondent*

November 14, 1980

Supreme Court, U. S.
FILED
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MICHAEL RODAK, JR., CLERK

No. 80-515

# In the Supreme Court of the United States

OCTOBER TERM, 1980

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W. C. YORK, PETITIONER

*v.*

FEDERAL HOME LOAN BANK BOARD, ET AL.

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT*

---

## BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

---

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## BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

---

### QUESTION PRESENTED

Whether the decision of the Federal Home Loan Bank Board approving the application of First Federal Savings and Loan Association of Raleigh, a federally-chartered mutual association, to alter the form of its business organization to that of a stock association, was arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law.

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* Additional respondents are Federal Savings And Loan Insurance Corporation and intervenor First Federal Savings And Loan Association of Raleigh.

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## OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a-9a) is reported at 624 F.2d 495.

## JURISDICTION

The judgment of the court of appeals was entered on July 1, 1980. The petition for a writ of certiorari was filed on September 29, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## STATEMENT

1. Respondent Federal Home Loan Bank Board is the federal agency responsible for the chartering, organization, supervision and regulation of federal savings and loan associations. Section 5(a) of the Home Owners' Loan Act of 1933, 12 U.S.C. 1464(a). Respondent Federal Savings and Loan Insurance Corporation (FSLIC) operates under the direction and control of the Board. 12 U.S.C. 1437(b), 1725 (a), and (c), and 1730(k)(1). FSLIC insures the accounts of all federal associations, as well as eligible state associations, and regulates insured institutions under Title IV of the National Housing Act, 12 U.S.C. 1724 *et seq.* The Board and FSLIC are responsible, *inter alia*, for approving and regulating conversions of federal, and state-chartered FSLIC-insured, mutual saving and loan associations to federal or state-chartered stock associations. See 12 U.S.C. 1464(i), 1725(j); 12 C.F.R. Part 563b; Pet. App. 3a-6a.

2. By resolution No. 79-298, dated May 17, 1979, the Board approved the application of respondent

First Federal Savings and Loan Association of Raleigh (First Federal) to convert from a federal mutual savings and loan association to a federal stock savings and loan association, pursuant to a sale-of-stock conversion plan that was authorized by First Federal's charter (Pet. App. 2a) and satisfied the Board's conversion regulations (12 C.F.R. Part 563b).[1] On June 29, 1979, the members of First Federal overwhelmingly approved the conversion plan; 71.6% of the total outstanding votes were cast in favor of the plan, while only 5.9% were cast against it (Pet. App. 2a).

Petitioner, a depositor-member of the association, thereafter petitioned for review in the court of appeals. Principally, petitioner claimed that the conversion was illegal because the Board's statutory approval authority (Section 402(j) of the National Housing Act, 12 U.S.C. 1725(j)) had expired. Alternatively, he claimed that the Board's approval of the conversion was arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law. The court of appeals rejected both claims (Pet. App. 1a-

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[1] A sale-of-stock conversion is one in which the converting association sells its capital stock at the estimated pro forma market value, with eligible depositors of the association having priority rights to subscribe for the purchase of the conversion stock issue. Since 1974, the Board has approved 90 such conversions, 59 of which have now been completed. The converting associations have thereby raised approximately $276.6 million in net capital (gross sales less expenses); these funds have enabled the converting associations to provide additional funds for home financing. As the Fourth Circuit noted, Congress confirmed the Board's statutory authority to approve such conversions in Pub. L. No. 93-495, 88 Stat. 1504, 12 U.S.C. 1725(j); that authority has not been revoked (Pet. App. 4a-7a).

9a). Petitioner challenges the judgment below only with respect to the court's rejection of his alternative claim.

## ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Accordingly, review by this Court is not warranted.

1. Petitioner's contention (Pet. 5-17) that the Board's approval of First Federal's conversion application violated his rights is insubstantial. The conversion was approved by majority vote of the association's members pursuant to established procedures, and the conversion also met the substantive and procedural requirements specified in the Board's regulations. While petitioner may disagree with the decisions made by his co-members and the action taken by the Board, he has no legal ground for complaint. The rights of an association member are limited by law and contract, and they are subject to alteration: "Holders of savings accounts and obligors of an association shall, *to such extent as may be provided by its charter or by regulations of the Board,* be members of the association, and *shall have such voting rights and such other rights as are thereby provided.*" 12 U.S.C. 1464(b)(1) (emphasis added).[2] The charters of all federal mutual associa-

[2] Federally-chartered mutual savings and loan associations, because of their federal charters and the fact that they are creatures of federal law, are simply unlike other mutual associations such as insurance companies. The courts have consistently held that the Board's regulations govern the operations of every federal savings and loan association from organization to dissolution. See, *e.g.*, *Meyers* v. *Beverly Hills Federal Savings & Loan Association*, 499 F.2d 1145,

tions, including First Federal, provide that the charter may be amended; that the association is subject to federal law, rules and regulations; and that the association has the power, subject to Board approval, to convert to the stock association form. See 12 C.F.R. 544.1. In no sense, therefore, was there any unlawful "taking" when First Federal lawfully amended its charter and converted to a stock association in accordance with applicable federal regulations and with the overwhelming approval of its members.

Petitioner's contrary contention is based upon the incorrect assumption that association member-depositors have an "ownership interest" in the association equivalent to that of a shareholder in a typical corporation. In fact, the members of a federally chartered "deposit" [3] association are more similar to creditors

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1146 (9th Cir. 1974); *Kupiec* v. *Republic Federal Savings and Loan Association*, 512 F.2d 147, 150 (7th Cir. 1975). While principles of corporate law may be used as a model to develop federal common law to the extent that the Board has not specifically established the rights of association members (*Murphy* v. *Colonial Federal Savings and Loan Association*, 388 F.2d 609, 611 (2d Cir. 1967)), the Board has unquestioned authority to establish the rights of association members along different lines. 12 U.S.C. 1464(b)(1); *Kupiec* v. *Republic Federal Savings and Loan Association, supra*, 512 F.2d at 153-154.

[3] First Federal was a "deposit" association prior to conversion. Unlike the depositors of a "share" association, the depositors of a "deposit" association have no legal right to share in the profits of the association; they are entitled only to a contractually-fixed rate of return. In a "deposit" association, however, the depositors share at dissolution on an equal footing with all other creditors; the claims of depositors in a "share" association may be satisfied only after the claims of other creditors have been satisfied. The cases upon which

in that they receive a fixed, contractual rate of interest on their deposit accounts; they have no right to share in the profits or net worth of the association except in the unlikely event that the Board approves the liquidation of a solvent association. See 12 C.F.R. 545.1-2. See generally *Mengele* v. *Christiana Federal Savings and Loan Association*, 287 A.2d 395, 397 (Del. 1972); *In re Estate of Morey*, 38 Ill. 2d 575, 579, 232 N.E. 2d 734, 737 (1967); *Benton's Apparel, Inc* v. *Hegna*, 213 Minn. 271, 275-276, 7 N.W. 2d 3, 5-6 (1942); *Aberdeen Saving & Loan Ass'n* v. *Chase*, 157 Wash. 351, 369-370, 289 P. 536, 544 (1930).

2. Petitioner also contends (Pet. 16) that the conversion resulted in the unlawful "taking" of his "voting rights." Again, petitioner's contention lacks merit because, by definition, his voting rights were limited by law and contract. Because those rights were held subject to the possibility that they could be extinguished in certain circumstances, petitioner cannot complain that they were thus extinguished. The voting rights of association members are narrowly circumscribed: federal charters uniformly limit the maximum number of votes that a depositor may cast, regardless of the amount of his deposit account. See 12 C.F.R. 544.1(a)(4), 544.1(b)(4), 544.2(e). Voting rights are further limited in that the association's board of directors may generally approve or disapprove mergers without the consent of the mem-

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petitioner relies (Pet. 11-14) are inapposite in that they involved the rights of depositors in "share" associations. Likewise, petitioner incorrectly asserts (Pet. 12) that the FSLIC took a position in *Lanigan* v. *Apollo Savings*, 40 Ill. App. 3d 927, 353 N.E. 2d 239 (1976), that is inconsistent with its position here. *Lanigan* involved a state-chartered, FSLIC-insured "share" association, rather than a federally-chartered "deposit" association as is involved in this case.

bers. 12 C.F.R. 546.2(e). Likewise, the board of directors may redeem a depositor's account, thereby terminating his membership and extinguishing his voting rights. See 12 C.F.R. 544.1(a)(7), 544.1(b)(7). At all events, the conversion here, which was approved pursuant to the association's charter and federal regulations by an overwhelming majority of the outstanding votes, did not improperly abridge petitioner's rights.

3. Finally, petitioner contends (Pet. 16) that the conversion unlawfully eliminated his right to share in future earnings and surplus upon dissolution. That contention is insubstantial. As we have previously noted (pages 4-5 & n.3, *supra*), association members have no right to share in the earnings of a "deposit" association. Indeed, this Court has previously observed that a member's contingent interest in the assets of the association in the event of liquidation is largely ephemeral and without value. See *Society for Savings* v. *Bowers*, 349 U.S. 143, 150 (1955). Moreover, the terms of the conversion here fully provided for the protection of whatever interests depositors might have in the net worth of the association upon liquidation, by requiring the establishment of a special liquidation account equal to the amount of the association's net worth at the time of conversion. 12 C.F.R. 563b.3(c)(12), 563b.3(f).[4]

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[4] The function of the liquidation account is to establish a priority on liquidation for the benefit of mutual accountholders who retain their savings accounts in the converted association. Each eligible accountholder has a related inchoate interest in a portion of the liquidation account balance in an amount proportional to his qualifying deposits. In the unlikely event that the converted institution is subsequently liquidated, each eligible accountholder would be entitled to receive a liquidation distribution in the amount of his cur-

First Federal's conversion plan and the Board's conversion regulations thus provide full protection for the depositors' legitimate interests. Depositors receive a savings account in the converted stock association for the same amount, term and interest rate as their account in the former mutual association. 12 C.F.R. 563b.3(c)(11). They also have the first opportunity to purchase the new stock. 12 C.F.R. 563b.3(c)(2)-(5). Moreover, the change in form of organization, with its attendant change in voting rights, occurs only after the conversion plan has been approved by a majority of the votes. 12 C.F.R. 563b.6. Finally, this vote occurs only after all accountholders have received a detailed proxy statement fully describing all relevant aspects of the proposed conversion, including the change in their voting rights. 12 C.F.R. 563b.8 and 9.

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rent adjusted related interest in the liquidation account balance, before any assets could be distributed to the shareholders. The depositor's right to share in a distribution of the net worth of the association upon liquidation is thus enhanced, rather than diminished, by conversion because of the additional conversion-raised capital that is available to satisfy the liquidation rights of eligible accountholders. See 12 C.F.R. 563b.3(c)(12) and 563b.3(f).

Petitioner asserts (Pet. 16) that this special liquidation account does not adequately protect the rights of accountholders because it will not continue to grow in the same manner as the net worth of the prior mutual association. If an accountholder really wishes to continue to preserve whatever right he has to share in a growing net worth, however, he is free to transfer his funds to a mutual association.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 80-515

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# Supreme Court of The United States

OCTOBER TERM, 1980

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W. C. YORK,

*Petitioner,*

*v.*

FEDERAL HOME LOAN BANK BOARD

AND

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION,

*Respondents,*

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF RALEIGH

*Intervenor-Respondent.*

---

*On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit*

## MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE OF THE NATIONAL ASSOCIATION OF STATE SAVINGS AND LOAN SUPERVISORS

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## MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Now comes the National Association of State Savings and Loan Supervisors ("NASSLS") and moves that this Court permit it leave to file a brief in this matter as *amicus curiae* in support of respondents, and in support thereof say as follows:

1. The movant herein is an association composed of the officials of the several states whose responsibility it is to regulate state chartered savings and loan institutions in their respective states or territories.

2. The movant is established to represent state savings and loan supervisors. As the only organization representing state savings and loan supervisors, NASS&LS, alone, can represent the interests of those states whose laws are being challenged in this action. Its unique perspective can aid the Court by framing from a State viewpoint, the complex issues presented by this litigation.

3. The laws of some thirty states provide for the conversion of a state chartered mutual savings and loan association to a state chartered stock savings and loan association.

4. Several state chartered, Federally insured savings and loan associations have applied for regulatory approval to convert from mutual to stock form of organization. The associations have expended substantial funds in complying with the application requirements of their state supervisor and the Federal Savings and Loan Insurance Corporation, ("FSLIC"). Were petitioner W. C. York to prevail in this action the funds advanced by state chartered savings and loan associations in pursuit of their application would be lost. The loss of such funds as well as the opportu-

nity to generate new capital funds through the sale of conversion stock could have very serious effects on the capital positions and future prospects of the several state chartered institutions.

5. In North Carolina, alone, one state chartered, guaranty insured institution has completed the conversion process. Twelve applications for conversion by North Carolina institutions are currently pending, eleven are by state chartered, FSLIC insured institutions.

6. The Movant's interest derives from its concern for the effect that the decision in this case may have on the laws of the thirty states which provide for stock conversions and the savings and loan supervisor whose sworn duty it is to uphold such laws.

7. The Movant supports the rights of an individual state to provide for stock conversion of the savings and loan associations chartered pursuant to its laws.

8. The Movant has been active on federal and state levels in analyzing and commenting on the process for stock conversion of savings and loan associations, which is the issue involved in this action.

9. The Movant desires to offer analysis as to the effect of this litigation on the thirty some states whose laws provide for stock conversions, the state savings and loan supervisors who are sworn to uphold the laws of their states, and the state chartered mutual associations which have applied for regulatory approval to convert from mutual to stock form of organization.

WHEREAS, the Movant prays that it be given leave to file a brief as *amicus curiae* November 14, 1980.

FRANK R. GAILOR, *Esquire*
*National Association of State Savings and Loan Supervisors*
*Gailor, Elias & Matz*
*700 E Street, S.E.*
*Washington, D.C. 20003*
*(202) 543-1700*

**CERTIFICATE OF SERVICE**

Copies of the foregoing petition have been mailed to Mr. Harvey Simon, Office of General Counsel, Federal Home Loan Bank Board, 1700 G Street, N.W., Washington, D.C. 20552; Mr. Irving Like, 200 N. Main Street, Babylon, New York 11702; Mr. Wade H. McCree, Solicitor General, Department of Justice, Washington, D.C. 20530; and Mr. David W. Long, Poyner, Geraghty, Hartsfield & Townsend, 615 Oberlin Road, P.O. Box 10096; Raleigh, North Carolina 27605, on this 14th day of November, 1980.

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# In The
# Supreme Court of The United States

OCTOBER TERM, 1980

**No. 80-515**

W. C. YORK,

*Petitioner,*

*v.*

FEDERAL HOME LOAN BANK BOARD AND FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION,

*Respondents,*

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF RALEIGH,

*Intervenor-Respondent*

*On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit*

## BRIEF FOR THE NATIONAL ASSOCIATION OF STATE SAVINGS AND LOAN SUPERVISORS AS AMICUS CURIAE

## INTEREST of AMICUS CURIAE

The National Association of State Savings and Loan Supervisors and the individual supervisors whose responsibility it is to regulate savings and loans in the individual

states have a general interest in the manner in which the conversion question is resolved. With respect to the instant case, the issue of whether the Federal Home Loan Bank Board's action was arbitrary, capricious and an abuse of discretion is of utmost significance to state supervisors who have acted in reliance upon statutory authority. The resolution of this issue may significantly affect the extent to which the States may exercise jurisdiction within this subject matter. Thus, the principles, guidelines and methods of analysis used by the courts in resolving questions raised in this case are of paramount concern to the State supervisors joining in this brief.

## SUMMARY OF ARGUMENT

The suit brought on behalf of Mr. W. C. York challenges the authority of the FHLBB, as operating head of the FSLIC, to approve the conversion of mutual associations to capital stock form of organization. The suit assumes that the FHLBB has plenary jurisdiction over the subject of stock conversion; it ignores the fact that more than thirty states have enacted laws providing for the conversion of mutual associations to capital stock form of organization. Should the line of argument advanced by the Petitioner be sustained, a grave cloud could be cast over the validity of the laws of the thirty some states which permit stock conversions.

The potentially detrimental effects of such a holding have compelled the National Association of State Savings and Loan Supervisors ("NASS&LS") to enter as *amicus curiae* in this case. NASS&LS is an organization composed of state government officials responsible for regulating state chartered savings and loan associations throughout the United States and in its territories. The members of NASS&LS have a direct interest in the outcome of this case because it may affect the ability of state supervisors to approve conversion applications.

The Petitioner alleges that the approval of conversions from mutual to stock form constitutes a taking of property without compensation. The statute in question, 12 U.S.C. §1725(j), only provides a means by which associations may raise capital through conversion. A stock conversion is not a taking of property without just compensation. No ownership rights are taken. The ownership rights are fully protected and, in fact, actually enhanced in economic value through a complete set of regulations. Constitutionally ordained due process rights are always protected by requiring that stock conversions must, under state and federal law, be approved by an informed majority of the mutual depositors and borrowers. In addition, the fairness of the plan of conversion to members of state mutual associations is further assured by the requirement that the plan must be passed upon by federal as well as state authorities. Further protection is afforded by the appraisal process and the liquidation account which help protect against an unconstitutional taking.

## ARGUMENT

1. THE FHLBB AND FSLIC HAVE STATUTORY AUTHORITY TO APPROVE THE CONVERSION OF FEDERALLY CHARTERED MUTUAL SAVINGS AND LOAN ASSOCIATIONS TO STATE CHARTERED STOCK ASSOCIATIONS.

The Petitioner challenges the approval authority of the FHLBB and FSLIC and the manner in which it is exercised by the respective agencies. Two separate questions are involved. Each will be considered individually.

NASS&LS concurs in the view of the Court, below, concerning the FHLBB's authority to approve the conversion of federally chartered mutual to federally chartered stock associations.

It is important to note that the Petitioner does *not* challenge the statutory authority of the FSLIC to approve

the conversion of a federally chartered mutual association to a state chartered stock association. Nor does the Petitioner challenge the authority of the FSLIC to approve the conversion of a state chartered mutual association to a state chartered stock association. This authority has existed for three decades since the amendment of §5(i) of the Home Owners' Loan Act in 1948. 12 U.S.C. §1464(i).

2. THE CONVERSION PROCESS IS NEITHER ARBITRARY NOR CAPRICIOUS.

The Petitioner alleges that the approval of stock conversion by the FSLIC is *per se* arbitrary, capricious, and an abuse of discretion. The Court has said in reference to the Administrative Procedures Act standard:

> Section 706(2)(A) requires a finding that the actual notice made was not "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law." 5 U.S.C. §706(2)(A) (1964 ed., Supp V). To make this finding the court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment. *(Citations)* Although this inquiry into the facts is to be searching and careful, the ultimate standard if reviewed is a narrow one. The court is not empowered to substitute its judgment for that of the agency. Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416, 28 L. Ed 2d 136, 91 S. Ct. 814 (1971).

A further explanation of the arbitrary and capricious standard appears in United States Lines, Inc. v. Federal Maritime Commission, 584 F. 2d 519, 526 (D.C. Cir. 1978).

The Court's enunciated policy as to the larger equal protection question states:

> Corrollary to the rule that a legislative classification must be reasonable if it is to comport with the equal protection guaranty is the firmly established principle that a classification which is arbitrary or capricious fatally conflicts with the guaranty. Morey v. Doud,

354 U.S. 457, 1 L. Ed 2d 1485, 77 S. Ct. 1354; Walters v. St. Louis, 347 U.S. 231, 98 L. Ed 660, 74 S. Ct. 505; Niemotko v. Md., 340 U.S. 268, 95 L. Ed 267, 71 S. Ct. 325; Hartford Steamboiler Inspection and Insurance Company v. Harrison, 301 U.S. 459, 81 L. Ed 1223, 57 S. Ct. 838; Old Dearborn Distributing Co. v. Seagram Distillers Corp., 299 U.S. 183, 81 L. Ed 109, 57 S. Ct. 139.

A classification, in order that it may not violate the constitution and guaranty as to equal protection of the laws, is that the classification must not be capricious or arbitrary but must be reasonable and natural, and must have a rational basis. New York Rapid Transit Corp. v. N. Y., 303 U.S. 573, 82 L. Ed 1024, 58 S. Ct. 721, *reh den.*, 304 U.S. 588; 82 L. Ed 1548, 58 S. Ct. 939; Colgate v. Harvey, 296 U.S. 404, 80 L. Ed 299, 56 S. Ct. 252; Nicole v. Ames, 173 U.S. 509, 43 L. Ed 786, 19 S. Ct. 522; Minnesota *ex rel.* Pearson v. Probate Court, 309 U.S. 270, 84 L. Ed 744, 60 S. Ct. 523.
16 AM. JUR. 2d *Constitutional Law* §§ 498-499.

No decision since Morey v. Doud in 1957 has invalidated economic regulation legislation as arbitrary or capricious under the equal protection clause. In the Sunday Closing Laws case, McGowan v. Md., 366 U. S. 420, 6 L. Ed 2d 393, 81 S. Ct. 1101 (1961), Chief Justice Warren wrote:

The constitutional safeguard is offended only if the classification rests on grounds wholly irrelevant to the achievement of the State's objective . . . a statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it.

In a case involving a Kansas statute prohibiting debt adjusting, Justice Black cited earlier views:

In the face of our abandonment of the use of the "vague contours" of the Due Process Clause to nullify laws which a majority of the courts believed to be economically unwise. . . . We refuse to sit as a "super legislature to weigh the wisdom of legislation" and we refuse to go back to the time when courts used the due process laws "to strike down state laws, regulatory of business and industrial conditions because they

> may be unwise, improvident, or out of harmony with a particular school of thought" . . . . Whether the legislature takes for its text book Adam Smith, Herbert Spencer, Lord Keynes, or some other is no concern of ours. Ferguson v. Skrupa, 372 U.S. 726, 10 L. Ed 2d 93, 83 S. Ct. 1028 (1963). *See also,* Williamson v. Lee Optical Co., 348 U.S. 483, 99 L. Ed 563, 75 S. Ct. 461 (1955).

According to the Court in Ferguson v. Skrupa, unless the empowering legislation which permits the agency action runs afoul it is not for the courts to strike it down. Here, the FSLIC's conversion process is established by statute and the subsequent regulations show no evidence of being arbitrary or capricious. Therefore, petitioner's proper recourse is with the Congress and not the Court.

3. THE STATES IMPOSE RIGOROUS PROTECTIONS ON THE CONVERSION PROCESS IN ADDITION TO THOSE IMPOSED BY THE FSLIC.

The conversion of state chartered, federally insured mutual savings and loan associations can, under state law, only be accomplished upon the approval of both the state savings and loan supervisor and the FSLIC, e.g. VA. CODE §6.1-195.57. Such approvals, in fact, require independent assessments by the state savings and loan supervisor. In Arkansas, for example, the Arkansas Savings and Loan Association Board must, according to the application regulation, find upon a hearing on a petition for conversion that:

> (1) The plan for conversion proposed in said petition is fair and equitable to the members of the Mutual Association;
>
> (2) The notice to the members of the meeting to consider such plan of conversion fairly sets out the rights and obligations of the members under such plan;

(3) Under the plan of conversion each member of such Association is given the right to subscribe on a pro rata basis to his interest in the Mutual Association to stock in the resultant Stock Association, provided, fractional shares shall not be required to be issued;

(4) The plan of conversion makes adequate provision for the payment to each member of his pro rata interest in any excess special or general reserves of the Mutual Association and the value of any good will of the Association;

(5) The conversion to a Stock Association will not impair the Mutual Association's financial condition or its ability to pay withdrawals of savings accounts or other creditors;

(6) The converted Stock Association would meet the requirements under this Act for the granting of an original certificate of incorporation to a Stock Association under this Act;

(7) Not more than fifteen (15%) percent of the outstanding permanent capital stock of the converted Association will be owned directly or beneficially by any one individual.

Ark. Stat. Ann. §67-1852

It is the position of *amicus* that this independent state procedure, which precedes FSLIC action, is designed to safeguard the rights of members of the mutual institution and may, in and of itself, be enough to constitute the Board's action on the approval, safe from attack as wanting in a rational basis.

In reviewing the plan of conversion, the regulatory agencies, state and federal, guarantee that the rights of mutual members are fully protected. First, federal regulations mandate full disclosure of the plan to all eligible account holders. These account holders are informed in detail of the provisions of the plan, and explanation of management's decision to adopt the plan, as well as a statement of their rights to judicial review. 12 C.F.R. §563b.4(a)(ii)(4).

The plan of conversion must be voted upon and approved by the depositors of the association. 12 C.F.R. §563b.6. This vote has been held to constitute proper authorization to alter the property rights of the depositors. Harr v. FHLBB, 557 F. 2d 747, 751 (10th Cir. 1977).

Second, eligible account holders are entitled, under federal regulations, to purchase the greater of 200 shares, one-tenth of one percent of the total offering of stock or 15 times the product of his pro rata share of qualifying depositors multiplied by the number of shares to be sold. The stock which is subscribed for by eligible account holders is of the highest preference. Stock cannot be offered to supplemental account holders, directors, officers or employees, or the public if these eligible account holders exhaust the supply of available subscription rights. 12 C.F.R. §563b.3(c)(2).

If the eligible account holder decides to exercise his right not to purchase stock, a third mandatory provision in the conversion regulations requires that a liquidation account be established. 12 C.F.R. §563b.3(c)(11).

State laws provide similar protection when state chartered associations convert to stock form. See 18 OKLA. STAT. 171, §381.50.

## 4. NASS&LS REJECTS PETITIONER'S ASSERTION THAT THE LEGITIMACY OF MUTUAL-TYPE INSTITUTIONS HAS BEEN CALLED INTO QUESTION.

NASS&LS does not deny the important contribution of mutual-type institutions to home finance. Petitioner's argument that the result of the Fourth Circuit's decision in the instant case would "have the effect of throwing the status of the ownership of most or all mutual-type institutions into doubt" (p. 4, Petition) is, simply, wrong. NASS&LS is unaware of any confusion about this question among its members. The confusion, it would appear exists primarily in the mind of Petitioner.

## CONCLUSION

The approval by the Federal Home Loan Bank Board and Federal Savings and Loan Insurance Corporation and the proper state supervisory authorities of the conversion of a mutual savings and loan to a state chartered stock savings and loan is not arbitrary, capricious or in excess of statutory authority and is not a taking of any property rights without compensation. For the reasons stated above the *amicus curiae* urge that *certiorari* be denied.

Respectfully submitted,
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November, 1980

MOTION FILED
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No. 80-515

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1980

W. C. YORK,
*Petitioner*

v.

FEDERAL HOME LOAN BANK BOARD and
FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION,
*Respondents*

FIRST FEDERAL SAVINGS AND LOAN
ASSOCIATION OF RALEIGH,
*Intervenor-Respondent*

**On Petition For A Writ Of Certiorari To
The United States Court Of Appeals
For The Fourth Circuit**

## MOTION FOR PERMISSION TO FILE *AMICUS CURIAE* BRIEF

## AND

## BRIEF OF THE NORTH CAROLINA SAVINGS AND LOAN LEAGUE AS *AMICUS CURIAE* IN OPPOSITION

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**On Petition for a Writ of Certiorari to
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For the Fourth Circuit**

---

## MOTION FOR PERMISSION TO FILE *AMICUS CURIAE* BRIEF

**TO THE HONORABLE CHIEF JUSTICE AND TO THE HONORABLE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:**

The North Carolina Savings and Loan League ("League") hereby moves, pursuant to Rule 42 of the Rules of the Supreme Court of the United States, for permission to file

the within "Brief of the North Carolina Savings and Loan League as *Amicus Curiae* in Opposition" to Petition for Certiorari and as grounds therefor alleges as follows:

## I

The League is a trade organization which represents over 200 savings and loan associations in the State of North Carolina. Its membership includes state and federally chartered associations which exist in either mutual or stock form. The issue presented to this Court by the Petition for Certiorari concerns the legality of the conversion of a savings and loan association from mutual to stock form under current regulations of the Respondent Federal Savings and Loan Insurance Corporation ("FSLIC"). Many of the League's members have converted, or filed applications with the FSLIC for permission to convert, or are considering converting, to the stock form of organization, and the decision of this Court could materially affect the financial interest of such members, as described more fully in the within Brief. The League strongly believes that its members should have the freedom to choose between the mutual and the stock form of organization, and that mutual-to-stock conversions pursuant to the FSLIC's regulations do not violate the United States Constitution as Petitioner asserts.

## II

The League appeared below as *amicus curiae* and filed an extensive brief in support of the FSLIC's approval of the stock conversion of Intervenor-Respondent First Federal Savings and Loan Association of Raleigh. The League believes that the decision below was correct and that no further review is warranted.

## III

The League believes that its argument in support of the decision below and in opposition to the Petition for Certiorari, which includes citation and discussion of several relevant and important cases and other legal points and authorities, as well as discussion of the conversion process and the advantages of conversion, will materially assist the Court in determining whether or not to grant the Petition. Moreover, the League believes that such cases and other points of law may not be addressed in the Opposition brief filed on behalf of the respondent federal agencies or by the Intervenor-Respondent.

## IV

The League has asked for the consent of all parties to the filing of an *amicus curiae* brief. While counsel for the federal agency Respondents and counsel for the Intervenor-Respondent have given their written consent, counsel for Petitioner has refused to give his consent except upon conditions.

## V

Wherefore, the League prays that the within *amicus curiae* brief be filed.

Respectfully submitted,

ROBERT L. FREEDMAN
DANIEL J. GOLDBERG
ROLAND L. MARCOTTE, JR.
SILVER, FREEDMAN, HOUSLEY, TAFF & GOLDBERG

Dated: November 14, 1980 By .....

Robert L. Freedman
*(Attorney of Record)*
*Attorneys for the North Carolina Savings and Loan League*

## Question Presented for Review

Do conversions of savings and loan associations from mutual to stock form under the sale-of-stock regulations of the Federal Savings and Loan Insurance Corporation deprive the members of the converting association of their proprietary interest therein in a manner contrary to law?

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FIRST FEDERAL SAVINGS AND LOAN
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**On Petition for a Writ of Certiorari to
The United States Court of Appeals
For the Fourth Circuit**

---

## BRIEF OF THE NORTH CAROLINA SAVINGS AND LOAN LEAGUE AS *AMICUS CURIAE* IN OPPOSITION

### Statement of the Case

Petitioner W. C. York., a depositor at Intervenor-Respondent First Federal Savings and Loan Association of Raleigh ("First Federal") invoked the original jurisdiction of the court below, pursuant to Section 402(j)(4) of the National

Housing Act ("NHA"), 12 U.S.C. §1725(j)(4), to review the order of the Federal Home Loan Bank Board ("FHLBB"), as operating head of the Federal Savings and Loan Insurance Corporation ("FSLIC"), approving First Federal's application to convert from a federal mutual to a federal stock savings and loan association (savings and loan associations will sometimes hereinafter be referred to as "S&Ls").

The FHLBB approved First Federal's conversion under FSLIC regulations currently in effect and set forth at 12 C.F.R. Part 563b. These regulations permit conversions by FSLIC-insured institutions, both state and federally chartered, only on a sale-of-stock basis, wherein stock is first offered to members of the mutual S&L (the depositors and borrowers), as of specified record dates in a subscription offering, with any remaining stock thereafter offered to the general public at a predetermined and uniform price per share, based upon the *pro forma* market value of the converting institution. First Federal's conversion was overwhelmingly approved by its members at a Special Meeting held to consider its Plan of Conversion and was completed through the issuance of its conversion stock on September 6, 1979. In the court below, Petitioner challenged First Federal's conversion on both statutory authority and constitutional grounds. However, in the Petition for a Writ of Certiorari, Petitioner has limited the issue for which he seeks review to the question of whether this conversion, and other conversions under the FSLIC's regulatory framework, deprive the depositors in a converting mutual institution of their proprietary interests without just compensation. The United States Court of Appeals for the Fourth Circuit has ruled that none of Petitioner's claims have merit. *York v. Federal Home Loan Bank Board*, 624 F.2d 495 (4th Cir. 1980).

**Interest of the North Carolina Savings and Loan League**

The North Carolina Savings and Loan League ("League"), which appeared below as *amicus curiae*, is a trade organization chartered by the State of North Carolina and represents over 200 operating S&Ls in North Carolina. Its

membership consists of federally and state-chartered S&Ls, both mutual and stock in form. Among the League's members are S&Ls which have applications pending for permission to convert, or which are considering a mutual-to-stock conversion. The League's membership also includes S&Ls which intend to retain their present mutual form of organization.

While the League does not advocate the stock over the mutual form for its members, it strongly believes that all League members should be able to choose between these alternatives. Denial of the stock conversion alternative, such as Petitioner seeks in this action, is the denial of the right of S&Ls wishing to convert to expand their lending operations and customer services through the proceeds from the sale of conversion stock. Conversion for at least some of the League's members may be their only viable option in the future to compete for financial services with commercial banks, all of which are stock institutions, and with other financial entities, particularly as rate controls on savings accounts are lifted and the cost of money of savings and loan associations continues to increase.[1]

As of October 24, 1980, 34 S&Ls based in North Carolina have applied to the FSLIC for permission to convert to the stock form; of this number, 12 applications have been approved by the FSLIC, and 4 have been completed, raising net capital of $22.3 million for these four institutions. The conversion alternative has become especially significant for state-chartered League members in recent months since the North Carolina General Assembly enacted Chapter 798 of its 1979 Session Laws, North Carolina Gen. Stat. §354A-13 (effective January 1, 1980), which allows conversion on a sale-of-stock basis, provided the Plan of Conversion has been approved by the

[1] Title II of Public Law 96-221, 94 Stat. 132, 12 U.S.C. §3501, *et. seq.* (March 31, 1980), provides for the elimination of federal controls on interests rates which depository institutions may pay for savings deposits on April 1, 1986.

North Carolina Savings and Loan Commission ("Commission"). The Commission has adopted stock conversion regulations which are virtually identical to the FSLIC regulations under attack in this proceeding.[2]

## Summary of Argument

The League, believes that the Fourth Circuit's decision is correct and that no further review is warranted. The decision below, with regard to whether mutual-to-stock conversions under the FSLIC's sale-of-stock regulations are accomplished in accordance with due process requirements and adequately recognize the limited proprietary interest of depositors in a converting mutual association, is consistent with the views of the only other court of appeals which has considered stock conversions, *Harr* v. *Federal Home Loan Bank Board,* 557 F.2d 747 (10th Cir. 1977), is consistent with the views of the Internal Revenue Service as espoused in Revenue Ruling 80-105 (April 21, 1980) (which concludes that such conversions are tax-fee reorganizations), and is consistent with the will of Congress and most state legislatures which have mandated savings and loan conversions on the sale-of-stock basis.[3] Moreover, the decision below, which applies only to stock conversions by savings and loan associations, has no bearing on the rights of members of

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[2] Other states which have adopted sale-of-stock conversion laws patterned on the sale-of-stock framework of the FSLIC include Oklahoma, Okla. Stat. Tit. 18 § 381.50 (Supp. 1979), as amended by 1979 Okla. Sess. Laws, Sec. 1, Chap. 103 (H.R. 1737); Louisiana, La. Rev. Stat. §§6:950—6:950-1 (H.R. 1409, Reg. Sess., 1980); Maryland, Md. Financial Institutions Code Ann. §§9-601 to 9-612 (H.R. 1008, 1980); Connecticut, Conn. Gen. Stat. §36-1931; and Michigan, Mich. Comp. Laws Ann. §489.911

[3] As of June, 1974, a total of 22 states authorized mutual-to-stock conversions for S&Ls. S. Rep. No. 93-902, 93d Cong., 2d Sess. 3 (June 4, 1974). Since then, at least 5 additional states authorized sale-of-stock S&L mutual-to-stock conversions. See note 2 above.

other types of mutual institutions, such as credit unions, mutual life insurance companies and farmer cooperatives, and is fully consonant with the views of this Court on the limited property rights of mutual savings and loan members as expressed in *Society for Savings* v. *Bowers*, 349 U.S. 143 (1955).

## ARGUMENT

### A. The Advantages of Mutual to Stock Conversions

The legality of mutual-to-stock conversions must be judged, of course, based upon constitutional requirements, governing statutes, legislative history and relevant case law. In order to place the foregoing in proper perspective, however, the League will briefly explain why conversions by the sale-of-stock method are in the public interest.

Mutual-to-stock conversions of S&Ls have conferred, and will continue to confer, the following benefits:

- Conversions have markedly increased lending, savings growth and branching activity by converted institutions;
- Conversions have had a significant beneficial effect on the capital positions of converting S&Ls the majority of which had or would have had regulatory capital difficulties within five years or less in the absence of conversion;
- The capital adequacy problem has become particularly acute for the thrift industry because income on investments at most S&Ls has not kept pace with their skyrocketing cost of funds;
- The cost of funds is expected to continue to increase in the 1980's as federal rate controls are lifted and competition among all types of financial institutions increases under the general deregulation called for by Title II

of Public Law 96-221 (the "Depository Institutions Deregulation and Monetary Control Act of 1980"); and

- Conversions may increase S&Ls' profitability and speed their capital formation through bolstered earnings.

Problems with net worth and reserve requirements are often the major factor in an institution's decision to convert. Federal statutory law[4] and regulation[5] require that all FSLIC-insured institutions build up reserves to absorb losses, such reserves being calculated as a percentage of the institution's savings deposits. In addition, there are also minimum net worth requirements above the reserve requirement. These reserve and net worth requirements pose a particularly serious problem for mutual S&Ls since generally they must rely entirely upon earnings to meet regulatory reserve and net worth levels, and earnings, particularly in times of high inflation and high interest rates, simply cannot keep pace with increasing reserve and net worth requirements as savings at the institution grow. If earnings are not sufficient to meet reserve and net worth requirements, an S&L may be forced to curtail or eliminate savings growth.

Conversions are an effective means of remedying reserve and net worth deficiencies since the conversion proceeds immediately increase net worth, permitting a greater savings base while complying with reserve and net worth requirements. In addition, over a period of time, the earnings from the stock sale proceeds are added to the converted association's net worth, thus supporting further savings growth. The end result is that conversions support and increase the supply of lendable funds which can be used by converted associations for home loans, thus benefiting the Nation's housing industry.

Interest in mutual-to-stock conversions extends well beyond North Carolina. The FHLBB since 1975 has approved

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[4] Section 403(b) of the NHA, 12 U.S.C. §1726(b).

[5] 12 C.F.R. §563.13.

90 conversions, 59 of which have been completed following the issuance of nearly $300 million in conversion stock. This stock is held by thousands of stockholders throughout the nation, and some converted S&Ls have their stock listed on the New York Stock Exchange. Over 100 conversion applications are currently on file at the FHLBB, and a substantial number of S&Ls are preparing to file conversion applications. Many of the applicant and proposed applicant institutions are faced with very serious earnings and capital adequacy problems which should be remedied, at least in part, by their reorganization into the stock form.

**B. Conversions under the Sale-of-Stock Method do not Deprive Depositors of their Proprietary Interests without Just Compensation**

The FSLIC's existing conversion regulations, under which First Federal accomplished its conversion, are the culmination of a lengthy process involving the FHLBB, the United States Congress, the regulated industry, and the general public on the most equitable method to reorganize a mutual S&L to stock form. Although the FHLBB initially explored conversions wherein stock would be distributed without charge to an institution's members, the "free stock" type of conversion was ultimately rejected in regulations issued by the FHLBB in 1974 because studies of this approach indicated an inherent unfairness in distributing stock to persons who became depositors in anticipation of conversion, because savings shifts inherent in free stock conversions would disrupt financial markets, and because of other significant problems.[6] Congress agreed with the FHLBB that free stock distributions were unacceptable and instead sanctioned conversions by the sale-of-stock method embodied in the current regulations. Congress did, however, permit a handful of S&Ls which had applied to the FHLBB prior to adoption of its sale-of-stock regulations to convert on a

[6] *See*, 12 C.F.R. §563b.3(a).

free distribution basis. This "grandfather" provision, enacted in Public Law 93-495, appears at 12 U.S.C. §1725 (j)(2).

In the only other United States Court of Appeals decision to consider mutual-to-stock S&L conversions, the Tenth Circuit in *Harr* v. *Federal Home Loan Bank Board,* 557 F.2d 747 (1977), upheld the grandfathered "free stock" conversion of the one S&L which converted by this method. That conversion was challenged, among other grounds, on the basis that those persons who had opened savings accounts or increased the amount in their accounts after the record date approved by Congress for the free stock distribution had been deprived of their property interests without due process of law. The Tenth Circuit rejected this contention, stating that—

> . . . [a]s to the petitioners who were depositors before the closing date [i.e., the record date for stock distribution purposes], their interests were changed from that of a depositor in a mutual association to that of a stockholder in a stock association. This change was one authorized by law upon the proper vote of the depositors. These petitioners held their interests in the mutual association subject to the vote of the majority as provided by regulation. Their rights were thus at all times subject to this possibility as are the rights of shareholders generally. [*Id.* at 751]

The Tenth Circuit also noted that the free stock aspect of the conversion at issue "was contrary to any overall policy established by Congress but, as indicated, was authorized in a few specific instances." *Id.* at 750.

Petitioner argues that sale-of-stock conversions under the FSLIC's regulations (and by implication the laws of most states) violate the Fifth Amendment of the Constitution because they deprive depositors in the converting mutual S&L of their proprietary interests "without just compensation" (Petition for Certiorari, p. 5). To place this charge in proper context, a brief, general overview of the conversion process under the FSLIC's current regulations would be helpful.

The FSLIC's conversion regulations are designed to give the members of a mutual S&L the opportunity to purchase the entire stock issue through the exercise of stock subscription rights. These regulations, which, as noted above, appear at 12 C.F.R. Part 563b, apply to all FSLIC-insured, state-chartered associations, and to all federally chartered S&Ls, such as First Federal.

The process begins with the adoption by an institution's board of directors of a Plan of Conversion, which must strictly conform to required provisions in the conversion regulations. The Plan must provide that priority subscription rights to purchase the conversion stock be given to account holders as of a record date at least 90 days prior to adoption of the Plan of Conversion by the association's board of directors (a class denoted as "eligible account holders"). To the extent stock is available after eligible account holders have exercised their subscription rights, account holders and borrowers as of more recent record dates may subscribe for shares, and then members of management may be given rights to subscribe for a limited portion of the stock. Any stock left after the subscription period has ended is thereupon sold to the general public. In some cases all the stock is sold in the subscription period, and there is no need for a stock offering to the general public. The regulations require that the purchase price per share times the number of shares to be issued equal the pro forma market value of the S&L upon conversion, as determined by an independent person or firm expert in corporate appraisals.

Before a conversion can proceed, the Plan must be approved by majority vote of the association's members, following a special solicitation of proxies which includes a proxy statement disclosing all material facts about the association and the Plan of Conversion.[7] Such member vote occurs only after

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[7] As the Fourth Circuit noted, depositors in a mutual S&L, as a matter of industry-wide practice, ordinarily give management standard proxies to exercise the depositors' voting rights at the time the

(*footnote continues*)

the Plan of Conversion is reviewed for fairness by the FSLIC and is approved by that agency. In addition, the proxy solicitation material is reviewed by the FSLIC for adequacy of disclosure of material information relating to the Plan of Conversion, the financial condition and management of the converting institution, and the anticipated effects of conversion, and may not be used until the FSLIC clears it.[8] Congress has transferred from the Securities and Exchange Commission to the FHLBB enforcement of registration, reporting, and proxy solicitation requirements which apply to FSLIC-insured stock associations, including all converted associations, under the Securities Exchange Act of 1934.[9]

The depositor's proprietary interest in the net worth of a mutual S&L just prior to its conversion to the stock form is recognized under the conversion regulations by the requirement that the institution establish a "liquidation account" equal to the institution's net worth before conversion. Eligible depositors are given liquidation distribution rights in this account, pro-rated according to the percentage their individual accounts were of all savings accounts in the S&L as of the record date the institution used to determine the members of this class of depositors. These rights cannot increase but may decline in future years as these depositors close or reduce their savings accounts at the S&L. In the highly unlikely event the S&L is dissolved at some future time, and after all creditors (including depositors) are paid in full, the remaining assets of the S&L are

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(*footnote continued*)

account is opened. 624 F.2d at 497, n.1. The FSLIC's regulations prohibit the use of such proxies, however, for voting on a Plan of Conversion, and require a special solicitation of proxies to vote on such Plan.

[8] As noted, the FHLBB is the operating head of the FSLIC. Therefore, all references herein to the FSLIC also refer to the FHLBB.

[9] *See.* 15 U.S.C. §781(i).

used first to satisfy liquidation account rights in full, with any residue going to the stockholders.

It is apparent from the foregoing discussion that a mutual-to-stock conversion under the FSLIC's regulations is a process unique to the savings and loan business and does not, as Petitioner contends, have ramifications for other types of mutual institutions, such as life insurance companies, credit unions and farmer cooperatives (Petition for Certiorari, p.4)[10] Furthermore, it is clear that the Fourth Circuit properly rejected Petitioner's claim that this conversion process deprives depositors of their proprietary interests in violation of the Fifth Amendment.

The Fourth Circuit did not, as Petitioner contends, hold that members of a mutual S&L "have no significant rights other than those of creditors" (Petitioner for Certiorari, p. 8). Rather, the Court below recognized, as have many other courts,[11] the dual relationship of the depositor to the mutual S&L, both as "owner" of the institution, with liquidation and voting rights, and as a creditor. The creditor status of depositors has become particularly predominant at federal S&Ls since 1969, when legislation was enacted permitting federals to change from "share" type institutions (where account holders receive a return on their savings in the form of "dividends"; the dividend is invariably set at the competitive savings interest rate

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[10] In this regard, the Internal Revenue Service, in a Revenue Ruling issued on April 21, 1980, giving favorable tax treatment to stock conversions under the FSLIC's regulations, notes that "[t]he financial structure and control structure of federal regulated savings and loan associations . . . are unique among business organizations. Accordingly, the law and analysis as applied to these conversions is peculiar to such associations." Rev. Rul. 80-105, Internal Revenue Bull. No. 1980-16, page 5, April 21, 1980.

[11] *See, e.g., Mengele* v. *Christiana Federal Savings & Loan Association*, 287 A.2d 395 (Del. 1972), *Family Savings and Loan Association Shareholders' Protective Committee* v. *Stewart*, 215 A.2d 726, 728 (Md. 1966).

prevailing in the S&L business but a share S&L cannot pay any dividends unless it first meets all FSLIC reserve and net worth requirements)[12] to "deposit" type institutions (where account holders are paid for the use of their funds according to a fixed, contractual interest rate, irrespective of the S&L's earnings). *See,* 12 U.S.C. §1464(b)(1). Similar legislation has been adopted by most states. Since 1969, most S&Ls, including all converting associations, have been deposit institutions.[13] As the Fourth Circuit noted in the decision below, depositors in an FSLIC-insured association "do not share in the risk of loss since their deposits are federally insured, and their only opportunity to realize a gain of any kind would be in the event the savings and loan association dissolved or liquidated." 624 F.2d at 500.

Any inchoate right which depositors in a mutual S&L may have to any surplus resulting from the speculative and remote possibility of a voluntary liquidation of the institution clearly does not constitute a "property right" warranting compensation upon conversion. This Court, in *Society for Savings* v. *Bowers,* 349 U.S. 143,150 (1955), held that this "property right" does not rise to the level of an expectancy, and any theoretical value

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[12] Distributions to account holders in a share-type institution have not been treated by the Internal Revenue Service as "dividends" in the usual corporate sense. As the Supreme Court of Illinois noted in *Lanigan* v. *Apollo Savings,* 288 N.E. 2d 445, 450 (1972): "Federal tax provisions . . . require that dividends payable to withdrawable capital account holders are treated in the same manner as interest paid by banks. These payments are deductible in computing the association's taxable income. (Int. Rev. Code of 1954, sec. 591.) Correspondingly, the dividends received by an account holder are treated as ordinary interest income and are not eligible for a dividend exclusion. Int. Rev. Code of 1954, sec. 116(c)."

[13] In our inflationary economy with widely fluctuating interest rates, savers prefer the assurance of receiving the fixed, contractual interest rate offered by deposit S&Ls. The "share" S&L is rapidly becoming extinct.

which a depositor may have in such right reduces almost to the vanishing point.[14]

The deprivation of a mere hope or expectancy does not violate any constitutionally cognizable right of depositors in a mutual S&L and therefore does not require that compensation be paid to these depositors, as Petitioner claims. See *F.H.A.* v. *Darlington, Inc.*, 358 U.S. 84, 91 (1958); *Rocker* v. *Cardinal Building & Loan Ass'n*, 179 A. 667, 671 (Sup. Ct. N.J. 1935), *aff'd*, 194 A. 865 (N.J. 1937), upholding a New Jersey law which changed the withdrawal rights of present and future S&L account holders in State-chartered institutions; *Bucsi* v. *Longworth Building & Loan Association*, 194 A. 857, 863 (N.J. 1937), and *Family Savings and Loan Association Shareholders' Protective Committee* v. *Stewart*, 194 A.2d 118, 121 (Md. 1963).[15]

It is also significant that the Internal Revenue Service has concluded that "[s]ince the equity interest of a depositor in a mutual savings and loan association is more nominal than real, unlike that of a shareholder in a corporation, the conversion [under the FSLIC's regulations] into a ... stock savings and loan association is a mere change in identity, form, or place or organization within the meaning of section 368 (a) (1) (F) [of the Internal Revenue Code]" and thus a tax-free reorganization. *See*, Rev. Rul 80-105, Internal Revenue Bull. No. 1980-16, page 5, April 21, 1980.

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[14] The above observation in *Bowers* is of even greater force with respect to the conversion of First Federal and other deposit-type S&Ls, since *Bowers* dealt with the proprietary interests of account holders in a share-type institution.

[15] In the *Family Savings* case, the issue was whether Christmas Club account holders in a dissolved mutual S&L should be treated as creditors or shareholders (the court concluded they were creditors). In so holding, the Maryland Court of Appeals noted the shareholder-creditor duality of a mutual account holder and found that their rights "may be enlarged or restricted by special legislation, the Statute under which the corporation is incorporated, its charter or its by-laws." 194 A.2d at 121.

Endeavoring to make this case more attractive for *certiorari*, Petitioner suggests that the rationale of *Bowers* will cease to exist on March 31, 1986, when federal rate control authority—which limits the maximum interest rates payable by depository institutions—expires under the provisions of Title II of Public Law 96-221, and federal mutual S&Ls, according to Petitioner, then will be able to pay above-market rates of return to depositors (Petition for Certiorari, pp. 14-15).

Petitioner's argument is misplaced. First Federal's conversion was approved by the FHLBB on May 17, 1979, and its Plan of Conversion was approved by First Federal's members on June 29, 1979 (624 F. 2d at 497). Both events took place well before the enactment of Public Law 96-221 on March 31, 1980. Moreover, there simply is no basis for Petitioner to speculate that federal mutual S&Ls will be able to pay depositors above-market rates of interest or dividends six years from now when rate control authority expires, and that such future ability places a material value on depositors' present proprietary interest in the net worth of the federal mutual S&L. After March 31, 1986, depositors, as they do now, will seek the highest available fixed, contractual rate of return on their savings. And since federal mutual S&Ls must compete with stock S&Ls, commercial banks (which are all stock in form), credit unions, saving banks and other financial entities for savings deposits, it is entirely reasonable to anticipate that the market place—not the form of organization—will determine the rate of interest payable by financial intermediaries. Thus, if a mutual S&L were to pay above-market interest rates solely in order to return its surplus to depositors (including *new* depositors seeking the higher rates), it would not remain in business very long. Indeed, assuming, *arguendo*, future above-market rates are to be paid at all, such rates will be available only from a few S&Ls with a superior net worth and the need for greatly expanded savings flows to support unusually profitable lending. And assuming such circumstances may exist in the future, it is

the converted S&L—not the under-capitalized mutual—which likely will fall into this very limited and narrow category.[16]

Finally, the FSLIC's conversion regulations specifically require that the plan of conversion be approved by a vote of at least a majority of the total outstanding votes of the members of the converting S&L, 12 C.F.R. §563b.6(d) (and in conversions to date, or the average, over 95 percent of members voting on the Plans of Conversion voted to approve the Plans). As noted above, the law is clear that members hold "their interests in the [converting] mutual association subject to the vote of the majority as provided by regulation", and that "their rights were thus at all times subject to this possibility [of conversion] . . . ." *Harr* v. *Federal Home Loan Bank Board, supra,* 557 F. 2d at 751. It is especially significant that in the conversion at issue in *Harr,* only account holders as of July 13, 1972, were entitled to

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[16] Attempting to broaden the issue presented for review, Petitioner contends that when federal interest rate control authority expires in 1986, the sole justification for the retention of earnings by a federal mutual S&L would be to establish reserves for losses of the institution, and any surplus in excess of reserves should be paid to the depositors (Petition for Certiorari, p. 15). It is true that federal mutual S&Ls, like all FSLIC-insured institutions, are required under Section 403(b) of the NHA, 12 U.S.C. §1726(b), to establish reserves for the purpose of meeting losses. This requirement is the subject of a FHLBB regulation, 12 C.F.R. §563.13 as recently amended (45 Fed. Reg. 50718, July 31, 1980). In addition, the FHLBB also requires all FSLIC-insured institutions, including federal mutuals, to meet certain net worth requirements, which in most instances are significantly higher than the statutory reserve provided for in the NHA. See, 12 C.F.R. §563.13. Therefore, not only must earnings be retained as reserves against losses, but federal mutual S&Ls also must utilize earnings to meet the additional FHLBB net worth requirements. Furthermore, as noted above, FSLIC-insured S&Ls are unable to materially grow in terms of both asset and deposit size unless they have net worth and reserve accounts significantly in excess of those required by the FHLBB. Therefore, S&Ls, including federal mutuals, ordinarily utilize major portions of their earnings to "build up" these accounts to support future growth.

receive conversion stock under the association's grandfathered "free stock" conversion plan, even though the conversion was not consummated until April 15, 1976. Persons who opened new accounts, or increased their accounts, between these dates, got no conversion stock based on such new or increased accounts, nor was any type of "liquidation account" set up for them, nor did they receive any monetary compenstation. The Tenth Circuit rejected the contention of the petitioner in the *Harr* case that this made the plan of conversion illegal, and upheld the FHLBB's approval of the plan.

Therefore, the League submits that conversions do not destroy any meaningful property rights of depositors of converting S&Ls, and that a converting S&L is not required by law to compensate them upon reorganization as a stock S&L.

## CONCLUSION

The Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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